

**THE DOCTRINE AND APPLICATION OF PARTNERSHIP IN ISLAMIC
COMMERCIAL LAW WITH SPECIAL REFERENCE TO MALAYSIAN
EXPERIMENTS IN ISLAMIC BANKING AND FINANCE**

BY

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IN THE NAME OF *ALLĀH*
THE COMPASSIONATE, THE MERCIFUL

DECLARATION

I, the undersigned, hereby declare that this thesis is written by myself and any references made to the sources are duly acknowledged

 **JONI TAMKIN BORHAN**

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The present writer is aware both as a student and a Muslim of man's weakness in his search for truth and knowledge, unless assisted and willed by God. In this regard, I recite the normative statement as a maxim, with which the classical Muslim jurists and scholars concluded in their academic works: "This written work is accomplished only by the grace of Allāh and He knows best what is true and right, All gratitude and praise be only to Him".

Joni Tamkin Borhan,

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ABSTRACT

This thesis is a study of the doctrine of partnership (*muḍārabah* and *mushāarakah*) in Islamic commercial law and its application in Malaysian experiments in Islamic banking and finance. The aim of this thesis is to analyse the operations of the three main Islamic financial institutions in Malaysia, namely *Bank Islam Malaysia Berhad* (BIMB), *Syarikat Takaful Malaysia Sendirian Berhad* (Takaful Insurance Company Malaysia Limited) and *Lembaga Urusan Dan Tabung Haji* (The Malaysian Pilgrims Management and Fund Board) which claim to operate on the principles of Islamic commercial law.

The thesis falls into two parts: Part One focusses on the doctrine of partnership in Islamic commercial law, while Part Two consists of the application of the doctrine of partnership in the Malaysian experiments in Islamic banking and finance. After a general introduction, Part One divides into two chapters. Chapter One discusses the doctrine of *sharikah* (partnership) as a mode of financing in Islamic Commercial Law. Chapter Two deals with the doctrine of *muḍārabah* as a mode of financing in Islamic commercial law.

Part Two consists of three chapters (Chapters Three, Four and Five). Chapter Three examines and evaluates the operations and performance of the *BIMB* which operates on principles of Islamic Commercial Law such as *muḍārabah* and *mushāarakah*. Chapter Four examines the operations of *Syarikat Takaful Malaysia Sendirian Berhad* which operates Family and General Takaful Schemes based on the principles of *muḍārabah* and *takāful*. Chapter Five attempts to analyse the management and operations of *Tabung Haji* which was established in order to mobilize the voluntary savings of the Malaysian Muslims in accordance with the principles of *muḍārabah* and *ijārah*. The study ends with a conclusion and some suggestions and proposals to remedy the weaknesses in interest-free banking and finance in Malaysia, followed by a Bibliography.

NOTE ON BIBLIOGRAPHY

Malay names have been cited according to the standard bibliographical system employed in modern Malaysian studies in which the first name is put first. This applies to Malay names in both the English Sources (B) and Malay Sources (C) sections.

NOTES ON TRANSLITERATION

Consonants

Arabic	Symbol	Arabic	Symbol	Arabic	Symbol
ع	'	ز	z	ق	q
ب	b	س	s	ك	k
ت	t	ش	sh	ل	l
ث	th	ص	s	م	m
ج	j	ض	ḍ	ن	n
ح	ḥ	ط	ṭ	ه	h
خ	kh	ظ	ẓ	و	w
د	d	ع	ʿ	ي	y
ذ	dh	غ	gh		
ر	r	ف	f		

Vowels and Dipthongs

Long Vowel

ا ā
 و ū
 ي ī

Short Vowel

أ a
 و u
 ي i

Dipthongs

او aw
 اي ay

LIST OF ABBREVIATIONS

The following is a list of the abbreviations used for the most frequently consulted works:

<i>Aṣl</i>	Al-Shaybānī, <i>Kitāb al-Aṣl</i> , Part 1, (<i>Kitāb al-Buyūʿ wa al-Salam</i>).
<i>Awṭār</i>	Al-Shawkānī, <i>Nayl al-Awṭār</i> .
<i>Bidāyah</i>	Ibn Rushd, <i>Bidāyat al-Mujtahid wa Nihāyāt al-Muqtaṣid</i> .
Bukhārī	Al-Bukhārī, <i>Ṣaḥīḥ al-Bukhārī</i> .
Dusūqī	Al-Dusūqī, <i>Hāshiyat al-Dusūqī ʿAlā al-Sharḥ al-Kabīr</i> .
EI(1)	<i>The Encyclopaedia of Islam</i> (First Edition).
EI(2)	<i>The Encyclopaedia of Islam</i> (Second Edition).
<i>Fāʾiq</i>	Al-Zamakhsharī, <i>Al-Fāʾiq fī Gharīb al-Ḥadīth</i> .
<i>Fath Q.</i>	Ibn al-Humām, <i>Sharḥ Fath al-Qadīr</i> .
<i>Hash. A.</i>	Ibn ʿĀbidīn, <i>Hāshiyah Radd al-Mukhtār ʿAlā al-Durr al-Mukhtār</i> .
<i>Hidāyah</i>	Al-Marghīnānī, <i>Al-Hidāyah Sharḥ Bidāyat al-Mubtadī</i> .
Ibn al-Athīr	Ibn al-Athīr, <i>Al-Nihāyah fī Gharīb al-Ḥadīth wa al-Āthār</i> .
<i>Flām</i>	Ibn Qayyim al-Jawziyyah, <i>Flām al-Muwaqqiʿin ʿan Rabb al-ʿĀlamin</i> .
<i>Iṣābah</i>	Ibn Ḥajar al-ʿAsqalani, <i>Kitāb al-Iṣābah fī Tamyīz al-Ṣaḥābah</i> .
Jazīrī	Al-Jazīrī, <i>Kitāb al-Fiqh ʿAlā al-Madhāhib al-Arbaʿah</i> .
Kāsānī	Al-Kāsānī, <i>Kitāb Badāʾiʿ al-Sanāʾiʿ fī Tartīb al-Sharāʾiʿ</i> .

Lane	E.W.Lane, <i>Arabic-English Lexicon</i> .
<i>Lisān</i>	Ibn Manzūr, <i>Lisān al-^ʿArab</i> .
<i>Mabsūṭ</i>	Al-Sarakhsi, <i>Al-Mabsūṭ</i> .
<i>Minhāj</i> N.	Al-Nawawī, <i>Minhāj al-Ṭālibin</i> .
Muzanī	Al-Muzanī, <i>Kitāb al-Mukhtaṣar</i> , on the margin of al-Shāfiʿī's <i>Kitāb al-Umm</i> , Vol.VIII.
<i>Mufaṣṣal</i>	Jawad ^ʿ Alī, <i>Al-Mufaṣṣal fī Tārīkh al-^ʿArab Qabl al-Islām</i> .
<i>Mughnī</i>	Ibn Qudāmah, <i>Al-Mughnī</i> .
<i>Muḥallā</i>	Ibn Hazm, <i>Kitāb al-Muḥallā</i> .
<i>M. Muḥtāj</i>	Muḥammad al-Sharbīnī al-Khaṭīb, <i>Mughnī al-Muḥtāj</i> .
<i>Mukhtaṣar</i>	Khalīl b. Ishāq, <i>Al-Mukhtaṣar</i> .
Muslim	Muslim b. al-Hajjāj al-Qushayrī, <i>Sāḥih al-Muslim</i> .
<i>Muṣannaḥ</i>	Al-Sanʿānī, <i>Al-Muṣannaḥ</i> .
<i>Muw Sh.</i>	Mālik b. Anas al-Aṣbaḥī, <i>al-Muwaṭṭaʿ</i> . The version of Muḥammad b. Ḥasan al-Shaybānī.
<i>Muw Y.</i>	Mālik b. Anas al-Aṣbaḥī, <i>Al-Muwaṭṭaʿ</i> . The version of Yaḥyā b. Yaḥyā al-Laythī.
<i>Origins</i>	J. Schacht, <i>The Origins of Muhammadan Jurisprudence</i> .
Q.	Al-Qurʾān (Referring to The Qurʾān, the first figure indicates the number of <i>sūrah</i> and the second figure indicates the verse, e.g. 8:5).
<i>Qinā^ʿ</i>	Al-Bahūti, <i>Kashshāf al-Qinā^ʿ ʿAn Matn al-Iqnā^ʿ</i> .
Sahnūn	^ʿ Abd al-Salām b. Saʿīd b. Ḥabīb al-Tanūkhī, <i>Al-Mudawwanah al-Kubrā Li al-Imām Mālik b. Anas</i> .

Shirāzī	Al-Shirāzī, <i>Al-Muhadhdhab fī Fiqh Madhhab al-Imām al-Shāfi'i</i> .
S. Mizān	Al-Sha'arānī, <i>Mizān al-Kubrā</i> .
Tāj	Al-Zabīdī, <i>Tāj al-ʿArūs</i> .
Tanwīr	Al-Suyūṭī, <i>Tanwīr al-Hawālik Sharḥ ʿAlā Muwaṭṭa' Mālik</i> .
Tartīb	Al-Shāfi'i, <i>Tartīb Musnad al-Imām al-Shāfi'i</i> .
Transaction	Subhi Mahmasani, "Transaction in The Sharia", in <i>Law in The Middle East, Origin and Development of Islamic Law</i> .
Umm	Al-Shāfi'i, <i>Al-Umm</i> .
Wahbah	Wahbah al-Zuhaylī, <i>Al-Fiqh al-Islāmi wa Adillatuh</i> .
Wajiz	Al-Ghazālī, <i>Kitāb al-Wajiz fī Madhhab al-Imām al-Shāfi'i</i> .
Zurqānī	Al-Zurqānī, <i>Sharḥ al-Zurqānī ʿAlā Muwaṭṭa' al-Imām Mālik</i> .

JOURNALS

<i>AJISS</i>	<i>The American Journal of Islamic Social Sciences</i> , [Herndon, U.S.A.]
<i>ALQ</i>	<i>Arab Law Quarterly</i> , [London]
<i>BSOAS</i>	<i>Bulletin of School of Oriental and African Studies</i> , [London]
<i>HI</i>	<i>Hamdard Islamicus</i> , [Karachi, Pakistan]
<i>IC</i>	<i>Islamic Culture</i> , [Hyderabad]
<i>IJMES</i>	<i>International Journal of Middle Eastern Studies</i> , [Cambridge]
<i>IQ</i>	<i>The Islamic Quarterly</i> , [London]
<i>IS</i>	<i>Islamic Studies</i> , [Karachi and Islamabad, Pakistan]
<i>JAOS</i>	<i>Journal of the American Oriental Society</i> , [New Haven]
<i>JESHO</i>	<i>Journal of Economic and Social History of The Orient</i> , [Leiden]
<i>JIBF</i>	<i>Journal of Islamic Banking and Finance</i> , [Karachi]
<i>JIMMA</i>	<i>Journal Institute of Muslim Minority Affairs</i> , [London]
<i>JRAS</i>	<i>Journal of the Royal Asiatic Society</i> , [London]
<i>JRIE</i>	<i>Journal of Research in Islamic Economics</i> , [Jeddah]
<i>MW</i>	<i>The Muslim World</i> , [Hartford, Connecticut]
<i>NAH</i>	<i>Al-Nahdah</i> , [Kuala Lumpur]
<i>SI</i>	<i>Studia Islamica</i> , [Paris]
<i>SLJ</i>	<i>Syariah Law Journal</i> , [Petaling Jaya]

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INTRODUCTION

INTRODUCTION

One of the significant developments in the Muslim world in the last decades of the present century has been the emergence of a number of Islamic banks in certain Muslim as well as non-Muslim countries. The motivation for the establishment of these institutions comes from a desire to formulate and re-organize social and in particular financial activities in accordance with Islamic commercial law.

The theory of Islamic banking predates the practice of it. In non-Arabic languages, the earliest contributor to the notion of Islamic banking was Anwar Iqbal Qureshi in the late forties, who discussed profit-sharing as a substitute for interest, although in no great detail.¹ Uzair's *An Outline of Interestless Banking* in the fifties, though a small booklet of 21 pages, formulated an early version of the theory of interest-free banking. He briefly discussed the core of the future proposals on the subject, basing depositor-banker and banker-businessmen relations on the contract of *muḍārabah*.

A mature and comprehensive model of Islamic banking has resulted from works appearing in the late sixties and early seventies by a number of scholars, for example °Abd Allāh al-°Arabī,² Siddiqi,³ Mahmud Ahmad,⁴ al-Najjār,⁵ Bāqir al-Ṣadr,⁶

¹ *Islam and The Theory of Interest*, Lahore, 1967 (First published in Lahore in 1946). See especially pp. 130 - 133, which contain the idea of profit and loss sharing in its embryonic form. The researcher is not aware of any works on the subject in Arabic during the forties.

² "Contemporary Bank Transactions and Islam's View Thereon", *Islamic Thought*, Vol. II, (Aligarh, July 1967), pp. 55 - 64.

³ *Banking Without Interest*, Leicester, 1988, pp. 15 - 52. It was first published in 1969 in Urdu.

⁴ "Semantics of Theory of Interest", *Islamic Studies*, Vol. VI (2), (Rawalpindi, 1967), pp. 171 - 196.

Mannan,⁷ Gharīb al-Jammāl⁸ and Muṣṭafā ʿAbd Allāh al-Hamsharī.⁹ They have discussed the role of an Islamic bank as a financial intermediary mobilising savings from the public on the basis of profit-sharing such as *mudārabah*, *mushārah*, and making advances to entrepreneurs on the same basis. Profits of investments are shared between the bank and the entrepreneurs according to a mutually agreed percentage. Further, the bank shares these profits with depositors in the *mudārabah* accounts also according to a percentage agreed in advance. Liability to loss in capital in the bank-entrepreneurs and depositors-bank's investment is borne by the bank and depositors respectively. The entrepreneurs only lose their time and effort in the investment.

The central feature of an Islamic financial system is the replacement of the rate of interest with the rate of return on real activities as a mechanism for allocating financial resources. Islam, moreover, encourages trade which implies the permission to profit thereby.¹⁰ To facilitate trade transactions, Muslim jurists and scholars have developed specific forms of financial arrangement. The most important and unanimously agreed upon forms of financing provided by an Islamic bank or an Islamic financial institution are *mudārabah* and *mushārah* arrangements, as a principal means of earning profit without resort to charging interest. Both of these

⁵ *Bunūk Bilā Fawā'id Ka Istirāṭijīyah Li al-Tanmīyah al-Iqtisādīyah wa al-Ijtimā'īyah fī al-Duwal al-Islāmiyyah*, Jeddah, 1972, pp. 41 - 62.

⁶ *Al-Bank al-Lā Rabawī fī al-Islām*, Kuwait, n. d., pp. 76 - 127.

⁷ *Islamic Economics : Theory and Practice*, Lahore, 1982, pp. 217 - 250. It was first published in 1970.

⁸ *Al-Maṣārīf wa al-A'māl al-Maṣrafiyyah fī al-Sharī'ah al-Islāmiyyah wa al-Qānūn*, Cairo, 1972, 477pp.

⁹ *Al-A'māl al-Maṣrafiyyah wa al-Islām*, Cairo, 1973, pp. 75 - 206.

¹⁰ Q. 2 : 275 : "... Allāh has permitted trade and forbidden usury".

forms are essentially variants of partnership agreements in which loss (risk) and profit (return), in the case of a *mushārah* contract, are shared by the contracting parties. In the case of a *muḍārah* contract, however, profit (return) is shared between the provider of the capital and the agent-entrepreneur (the contracting parties), while loss, if any, is solely borne by the provider of the capital.

In the case of *muḍārah*, one party provides the necessary financial capital and the other (the agent-entrepreneur) the human capital needed for successful performance of the economic activity undertaken. The resulting profit is then shared between the parties in accordance with a sharing rule specified beforehand in a *muḍārah* contract. Under such an arrangement, if loss is incurred, it will be borne by the owner of the financial resources, while the entrepreneur risks the loss of his time and effort. Moreover, the entrepreneur is completely free to manage the project undertaken unless otherwise specified in the contract.

Muḍārah traditionally has been applied to commercial activities of short duration.¹¹ *Mushārah*, on the other hand, which is regarded as a complementary form to *muḍārah* financing, is applicable to production or commercial activities of longer duration. *Mushārah* is a form of business arrangement in which a number of partners pool their financial resources to undertake a commercial-industrial enterprise and share in the resulting profits (or losses) corresponding to their shares in the financial capital of the enterprise.

As has been mentioned earlier, Muslim economists and jurists appear to suggest

¹¹ Chapter Two, 2.1, pp. 1 - 4.

that the *muḍārabah* and *mushārah* contracts which are legal in Islam should be the basic methods (first-line techniques) in the transaction of Islamic banking and finance which permit risk-return sharing between the providers of capital and the entrepreneurs and by which financial resources are mobilised and combined with entrepreneurial and management skills for the purpose of expanding trade and investment. However, it is recognised that these techniques may not be applicable in all circumstances. Literature on Islamic banking and finance has mentioned other techniques of financing arrangements to meet such situations. These include *ijārah* (leasing), *ijārah wa istiqnā'* (hire-purchase/lease-purchase), *murābahah* (mark-up),¹² *bay' bi thaman ājil* (a trade-deal in which the seller allows the buyer to pay the price of a commodity at a future date in a lump sum or instalments), *bay' al-salam* (purchase with deferred delivery) and *qard ḥasan* (benevolent loans).

These latter modes of financing, however, are considered as the weaker Islamically speaking, because of their minimal risk and pre-determined fixed rate of return,¹³ and their preserving of the status quo associated with conventional banking, with its emphasis on creditworthiness of the client and maintenance of the credit-debtor relationship, rather than the risk-return sharing between the providers of capital in the case of *mushārah* and between the provider of capital and the entrepreneur in the case of *muḍārabah*.

¹² A contract in which a client wishing to purchase equipment or goods requests the bank to purchase the items and sell them to him at cost plus a declared profit. See Chapter Two, 2.7.1, pp. 116 - 124.

¹³ The report of the Council of Islamic Ideology of Pakistan on the elimination of interest, for example, sounded a note of caution in this regard in these words: "However, although this mode of financing is understood to be permissible under the *Sharī'ah*, it would not be advisable to use it widely or indiscriminately in view of the danger attached to it of opening a back door for dealing on the basis of interest". See Chapter 3, 3.2.2, footnote 47.

The Purpose of the Inquiry

The present study seeks to analyse and examine the application of *muḍārabah* and *mushārah* modes of financing in the operations of *BIMB*, *Syarikat Takaful* and *Tabung Haji* in Malaysia. This study will also be devoted to various aspects of financing operations as practised by these three main Islamic financial institutions in Malaysia.

Islamic banking, which has been defined as "banking in consonance with the ethos of the value systems of Islam" is expected to practice its transactions on the basis of the principles of Islamic commercial law and also to participate actively in achieving the goals and objectives of an Islamic economy.¹⁴ Ideally, an Islamic bank is not merely a bank that is not involved with any form of interest on loan and deposits. It is also not simply a bank that refrains from financing services and commodities prohibited in Islam. Neither is it just a development or investment bank nor a financial intermediary whose operations are linked with profit and loss-sharing.

An Islamic bank is rather perceived as an institution with integrated features that can be considered a social, investment and development bank. In view of the present situation of the Muslim ummah, which often considers the Islamic bank a stepping stone towards Islamising the economy, the bank is entrusted with a gigantic task. It is expected to function not merely in economic aspects but more importantly as a means to foster spiritual values, a centre of enlightenment, a school of morality, and

¹⁴ Ahmed (1984), pp. 8, 11 - 12; Mohsin S. Khan, "Islamic Interest-Free Banking : A Theoretical Analysis", in *Encyclopaedia of Islamic Banking and Insurance*, London, 1995, pp. 50 - 51; *The Concise Encyclopaedia of Islam*, London, 1989, s.v. "Islamic Banking".

a practical method leading to a condition of dignity for the ummah and a buttress for the economies of the Muslim countries.¹⁵

The practical experiences of Islamic banks in general and *BIMB*, *Syarikat Takaful Malaysia Sendirian Berhad (STMSB)* and *Lembaga Urusan dan Tabung Haji (LUTH)* in particular, however, reflect a perception that they seem to ignore the above distinctive nature of Islamic banks and financial institutions. Many people feel that *BIMB* in particular and *Syarikat Takaful* and *Tabung Haji* in general are too concerned with profits, at the expense of a more noble role they should play. In addition, *BIMB* has confined its modes of financing to mainly *murābaḥah* and *bay' bi thaman ājil* rather than *muḍārabah* and *mushārahah*, which theoretically are the main modes of financing operation of an Islamic bank. Furthermore, the mark-ups charged by the bank are about the same as the rate of interest. This has led some people to accuse the bank of continuing to practise interest but disguising it under different names. Consequently, the costs of finance advanced by an Islamic bank under *murābaḥah* and *bay' bi thaman ājil* principles are still high and comparable to the cost charged by conventional banks based on interest.

This is thus the basis for some people to question the real status of the bank, whether it is really an Islamic bank as assumed or merely an 'interest-free' commercial bank. There are also apprehensions among Muslim scholars that *murābaḥah* and *bay' bi thaman ājil* modes of financing may deteriorate into mere financing arrangements with the agreed profit margin being no more than a

¹⁵. Sayed al-Hawary, "The Distinctive Nature of Islamic Banks", paper presented at the *First Advanced Course on Islamic Banks* organised by International Institute of Islamic Banking and Economics, Cairo, 28 August to 17 September, 1981.

camouflage for interest. In this respect, it is expected that Islamic banks should avoid using them widely or indiscriminately.¹⁶

The Scope of This Study

This study covers the doctrines of partnership in Islamic Commercial Law which constitute *muḍārabah* (dormant-partnership) and *sharikah* (partnership), both of which have been thoroughly studied and carefully developed by the jurists (*fuqahā'*) in their legal works. These two modes of financing are essentially regarded as the main variants of partnership arrangement in Islamic Commercial Law due to the fact that risk and return are shared by the contracting parties. As an exception, only in the *muḍārabah* arrangement, risk is borne by the provider of the financial capital.

In this regard, other themes which are included in Islamic Commercial Law such as *muzāra'ah* and *musāqāt* (two types of sharecropping) have not been studied in the present work because they are not pertinent to the operations of the Malaysian Islamic banking and finance. The study of *ribā*¹⁷ (usury) is also not included, except

¹⁶ M. U. Chapra, *Towards A Just Monetary System*, Leicester, 1986, p. 171.

¹⁷ *Ribā* literally means increase, addition, expansion or growth (*Lisān*, Vol. XIX, p. 17 - 20; *Tāj*, Vol. X, pp. 142 - 143). The same meaning is also unanimously indicated in all Qur'ān commentaries. See for example al-Ṭabari, *Jāmi' al-Bayān*, Vol. III, p. 69. It is, however, not every increase or growth which has been prohibited by Islam. Technically, *ribā* refers to the premium that must be paid by the borrower to the lender along with the principal amount as a condition for the loan or for an extension in its maturity (Ibn Manẓūr specifies that what is prohibited is the extra amount, benefit or advantage received on any loan. *Lisān*, Vol. XIX, p. 304; see also commentary on verse 2 : 275 in Abū Bakr al-Jaṣṣāṣ, *Aḥkām al-Qur'ān*, Vol. II, ed. Muḥammad al-Ṣādiq Qamhāwī, Cairo, n. d., p183; Ibn al-ʿArabī, *Aḥkām al-Qur'ān*, Vol. I, Cairo, 1967, p. 242; al-Ṭabari, *op. cit.*, Vol. III, p. 69). After studying the various forms of business and credit transactions containing an element of *ribā* which were in Arabia during the time of the Prophet Muḥammad, *ribā* may be defined as a predetermined excess or surplus over and above the loan received by the creditor conditionally in relation to a specified period. In this sense, *ribā* has the same meaning as interest by the consensus of all the *fuqahā'* without exception (Jazirī, II, p. 245). *Ribā* has also been defined as excess (*faḍl*) in the exchange of six commodities (gold, silver, wheat, barley, dates and salt) which if they are exchanged against themselves, should be exchanged on the spot, equal and alike (Muslim,

that it is mentioned under various topics which are related to it. It is considered to be unnecessary to discuss it in detail in the present study, since the subject of *ribā* has been extensively covered by many researchers in recent years. This study also does not discuss the framework and operations of other Islamic financial institutions in Malaysia such as The Islamic Mortgage Company, *Baitul Mal*, *Yayasan Pembangunan Ekonomi Islam Malaysia (YAPEIM)* and Islamic Cooperatives.

This study is an attempt to analyse the way the two main modes of financing, i.e. *muḍārabah* and *mushārah*, are practised by the three main Islamic financial institutions in Malaysia, in order to help them to practice them in accordance with Islamic Commercial Law, and to avoid any possibility of the profit paid to the depositors of *BIMB* and *Tabung Haji*, and the participants in the case of *Syarikat Takāful*, containing an element of interest.

BIMB, *Syarikat Takāful* and *Tabung Haji* are chosen as the case studies in this research because they are the main Islamic financial institutions in Malaysia operating based on Islamic principles. *BIMB* is the first bank granted permission to operate all its transactions based on the principles of Islamic commercial law. *Syarikat Takāful* is the only financial institution to offer and operate Islamic *Takāful* schemes based on *muḍārabah* and *takāful* contracts. It has a major role as an intermediary institution

Ṣaḥīḥ Muslim, "*Kitāb al-Musaqāt*", Vol. III, p. 1211; *Awṭār*, Vol. V, p. 297). Some modern scholars try to confine the meaning of *ribā* merely to excessive interest and that the Qur'ānic references to "doubling and redoubling" of the principal apply to this type of excess (S. F. Ulgener, "Monetary Conditions of Economic Growth and the Islamic Concept of Interest", *Islamic Review*, Vol. 55 (2), 1967, p. 12; F. Rahman, "*Ribā* and Interest", *IS*, Vol. III (1), 1964, p. 30). The *Fuqahā'* are unanimous that this notion can lead to arbitrariness, and in any case, they argue that all forms of interest are banned. The most widely used argument for this stand is the verse of the Qur'an (Q. 2 : 279) that is interpreted to suggest the recovery of only the principal (Z. Ahmad, "The Theory of *Ribā*", *IS*, Vol. XIV (4), 1978, p. 179; Abū Zahrah, *Buḥūth fī al-Ribā*, Kuwait, 1970, p. 53).

in mobilizing funds from the participants in both General *Takāful* Schemes and Family *Takāful* Plans to be invested in any profitable venture and investment which will yield profits. Further, in Malaysia *Tabung Haji* is the oldest Islamic financial institution and appears as one of the largest Islamic holding companies.

In doing so, the views of the four major schools of Islamic Law, viz. the Mālikīs, Hanafīs, Shāfi'īs and Hanbalīs, will be the main basis of this study. The different views of these schools will be assessed in accordance with the relevant evidence used to support their position and the exigencies of the times. However, for the purpose of comparison and to give more scope for discussion, the views of other schools such as the Zahirīs, Ja'farīs and Zaydīs and, in addition, the views of early individual (independent) jurists such as al-Zuhri of the Hijāz (d. 124/742), Ibn Abī Laylā of Kūfah (d. 148/765), al-Awzā'i of Syria (d. 157/774) and Sufyān al-Thawri of Kūfah (d. 161/778) will also be touched on briefly from time to time where it seems appropriate. Although some of these views were expressed in the early period of Islam they may need to be reexamined in the light of the present situation. These views and the discussions therein are still relevant and worth studying.

Although the inquiry in Part One is primarily concerned with the legal aspects of *muḍārabah* and *mushārah*, reference will also be made to the literature of the Qur'ān and its exegesis, *al-sirah* (biography of the Prophet), his Traditions, the practices of the Companions of the Prophet, treatises, biographies and historical annals since these accounts are indispensable for an understanding and comprehension of the subject in its totality.

As far as Part One is concerned, this study covers no specific period of time.

This is due to its very nature. For the prolific yet scattered writings of the jurists on the subject stretch from the inception of the Islamic intellectual milieu until about the seventh and eighth centuries A. H. when the period of decadence began and the so-called closure of the gate of *ijtihād* prevailed. However, most of the subject-matter analysed in the first part is from the works of early jurists.

In Part Two, the material used is mainly from late and modern works, especially in the discussions of the operations of *BIMB*, *Syarikat Takaful* and *Tabung Haji*. Therefore, the annual reports of *Bank Negara Malaysia* (Central Bank of Malaysia), and the annual reports of the concerned institutions discussed, together with articles, magazines, newspapers, reports and statutes, will be the main sources of reference for analysing the application of *muḍārabah* and *mushārah* in their operations.

A Brief Survey of the Sources

So far little has been written in English on the doctrine of partnership in Islamic commercial law. In particular, no comprehensive attempt has been made to analyse the application of the above doctrine in the operations of Malaysian Islamic banking and finance.

In the case of Part One, the main sources of information on the subjects are from, in general, the materials of Islamic *fiqh*. Therefore, the books of Islamic jurisprudence (*fiqh*) are the primary sources of information and form the basis of analysis for the problems and issues in question.

The following, among others, are the general legal works used in Part One : *al-*

Mudawwanah al-Kubrā by Saḥnūn, *Kitāb al-Umm* by al-Shāfiʿī, *al-Muḥallā* by Ibn Hazm, *Kitāb al-Mabsūṭ* by al-Sarakhsī, *Badāʾiʿ al-Ṣanāʾiʿ fī Tartīb al-Sharāʾiʿ* by al-Kāsānī, and *al-Mughnī* by Ibn Qudāmah. In addition, the works of early exegetes such as *Jāmiʿ al-Bayān ʿAn Taʾwīl Āy al-Qurʾān* by al-Ṭabarī and *al-Jāmiʿ Li Ahkām al-Qurʾān* by al-Qurṭubī have also been consulted in order to serve as a supporting evidence for each case and to be compared with the understanding of the jurists. The same applies to the books of Traditions of the Prophet. Since the jurists frequently quote Traditions to support their views on every case, resort to the books of Traditions is indispensable in order to ascertain their validity and applicability to the case in point. Amongst the frequently consulted books of Traditions are *al-Muwattaʾ* by Mālik b. Anas, *al-Muṣannaf* by al-Ṣanʿānī, *al-Musnad* by Aḥmad b. Ḥanbal, *Ṣaḥīḥ al-Bukhārī* by al-Bukhārī, *Ṣaḥīḥ Muslim* by Muslim and *Sunan* by Abū Dāwūd.

Amongst the modern works related to the subject are the following:

- i) *Partnership and Profit in Medieval Islam* written by Abraham L. Udovitch, first published in Princeton, New Jersey, 1970. The treatise gives some accounts of the commercial transactions such as *sharikah* which prevailed in medieval Islam. The use of this contract in the operations of modern Islamic banking and finance had never been discussed. However, the book seems to be well researched by providing many primary sources. Therefore, it is a useful reference for a basic understanding of the subject.
- ii) *Al-Sharikāt fī al-Shariʿah al-Islāmiyyah wa al-Qanūn al-Waḍʿī*, by ʿAbd al-ʿAzīz al-Khayyāṭ, 2 Vols., Beirut, 1984. Since the author directly deals with the subject, it covers most of the topics pertaining to *sharikah* in Islam such as classification of

sharikah, *muḍārabah*, dissolution of the contract and distribution of the profit in a contract. The book, on the other hand, does not discuss how these contracts can be applied in the operations of Islamic banking and finance. In short, the work is a theoretically invaluable reference on the subject.

iii) Waqar Masood Khan, "*Towards an Interest-free Islamic Economic System*".¹⁸

Although the book is brief and small in size (126 pp.), it is a useful reference on the subject and the author has made a useful theoretical contribution to the field.

iv) More recently, Shahrukh Rafi Khan in his works "*Profit and Loss Sharing : An Islamic Experiment in Finance and Banking*"¹⁹ has examined the origin of, and the institutional and ethical issues underlying the Islamic banking movement and its adaptation of financial instruments including profit and loss-sharing (PLS). He discusses very briefly the doctrine of partnership as explained by the jurists. Despite the research being focussed on the Pakistani experiments in Islamic banking, it is an invaluable reference on the subject.

v) Another work dealing with the subject is "*Modelling an Interest-Free Economy*"²⁰ written by Muhammad Anwar. The author has discussed mainly the theoretical aspects of an Interest-free Economy. Although the book is small in size (119 pp.), it is very informative on the subject.

vi) Within the Malaysian context, Azlan Khalili Shamsuddin in his M. A. thesis "*Banking and Public Finance in Islam*",²¹ which was submitted to New York

¹⁸ Originally a Ph. D thesis submitted to Boston University, in 1983 and later published by The Islamic Foundation, Leicester, in 1985.

¹⁹ The work was originally a Ph. D thesis completed at University of Michigan, in 1987 and was published by Oxford University Press, Karachi, in 1987 (180 pp.).

²⁰ The work was originally a Ph. D thesis submitted to the University of Hampshire, in 1987 and was published by the International Institute of Islamic Thought, Herndon, in 1987.

²¹ This thesis was published by Dewan Pustaka Fajar, Kuala Lumpur, Malaysia in 1988.

University, in 1987, has only discussed the theoretical framework of Islamic banking and finance in Islam in a narrative manner. Although the author mentions briefly the concepts of *muḍārabah* and *mushārah* as a substitute for interest in banking practices, he does not mention the application of these contracts in the operations of Islamic banking and financial institutions in Malaysia.

Apart from what has been mentioned, there are numerous articles and working papers related to the Malaysian Islamic banking and finance which I have benefitted from: Syed Waseem Ahmad, **"Islamic Insurance in Malaysia"**; Radiah Abdul Kader, **"The Malaysian Pilgrims Management and Fund Board and Resource Mobilization"**; Abdul Halim Ismail, **"Bank Islam : Prospect dan Perkembangannya Pada Masa Hadapan"**; Badariah Sahamid, **"Bank Islam Malaysia Berhad : Konsep Dan Amalan"**; Mohd. Fadzli Yusuf, **"The Principle of Islamic Insurance in Malaysia"** and W. M. Wan Hussein, **"Pengurusan Kewangan dan Pelaburan Islam : Pengalaman Tabung Haji"**.

These sources complement each other and therefore for the purpose of this study they need to be rearranged and analysed in order to show the feasibility and viability of *muḍārabah* and *mushārah* contracts as developed by jurists in their legal works in the operations of Malaysian Islamic banking and finance.

PART ONE

THE DOCTRINE OF PARTNERSHIP IN ISLAMIC COMMERCIAL LAW

CHAPTER ONE

***SHARIKAH* (PARTNERSHIP) AS A MODE OF FINANCING**

CHAPTER ONE : *SHARIKAH* (PARTNERSHIP) AS A MODE OF FINANCING

Introduction

In this chapter we consider the concept and legitimacy of *sharikah* (Partnership) in Islamic commercial law. The topics to be discussed are, among others, the definition of *sharikah*, its legitimacy and the classification of *sharikat al-ʿuqūd* (commercial partnership).

1.1. Definition

The literal meaning of the word *sharikah* is sharing, participating or participation, partaking or co-partnership.¹ Legally, *sharikah* means that a property or thing belongs to several owners or co-proprietors in such a way that every one has ownership of every smallest part of it in proportion to the share allotted to him.² What the jurists, therefore, understand primarily by *sharikah* is proprietary partnership (*sharikat al-amlāk*)³ which arises, for example, through inheritance (*mirāth*) or gift. *Sharikat al-*

¹ *Lisān*, Vol. X, pp. 448 - 449; Lane, Vol. II, p. 1542.

² *Mughnī*, Vol. V, p. 1; *M. Muhtāj*, Vol. II, p. 211; *Hash. A.*, Vol. III, p. 364; *Bidāyah*, Vol. II, pp. 189 - 193; *Minhāj* N, pp. 132 - 133; *Mabsūf*, Vol. XI, p. 151; *Fath Q.*, Vol. VI, p. 152; Cf. ʿAlī al-Khafīf, *Aḥkām al-muʿāmalat al-sharʿiyyah*, n. d., pp. 483 - 484; W. Heffening, "*Shirka*", *El(I)*, Vol. IV, 1934, pp. 380 - 381.

³ *Sharikat al-mulk* (plural, *al-amlāk*) implies co-ownership and comes into existence when two or more persons happen to get joint-ownership of some asset without having entered into a formal partnership agreement; for example, two persons receive an inheritance or gift of land or property which may or may not be divisible. The partners have to share the gift, or inherited property or its income, in accordance with their share in it until they decide to divide it (if it is divisible, e.g. land) or sell it (if it is indivisible, e.g. a house). If the property is divisible and the partners still decide to stick together, the *sharikat al-milk* is termed *ikhtiyāriyyah* (voluntary). However, if it is indivisible and they are constrained to stay together, the

amlāk, the essence of which is common ownership of property, cannot be considered as partnership in a strict sense because it has not come into existence by mutual agreement to share profits and risks. Accordingly, it appears in *fiqh* discussions as a peripheral notion. The second kind of *sharikah* as understood by the jurists was not only primarily proprietary partnership, but also commercial partnership (*sharikat al-ʿuqūd*).⁴

According to Udovitch,⁵ the brief statement on proprietary partnership (*sharikat al-amlāk*) first found in al-Qudūri's *Mukhtaṣar*⁶ is repeated with only slight elaboration in most succeeding Hanafī treatises. For example, al-Sarakhsī writes:

Proprietary partnership occurs when two people are partners in the possession of property. This can be of two kinds: firstly, a partnership which becomes effective without any action on their part, as, for example, in the case of inheritance; secondly, a partnership which becomes effective through their own actions. This comes about through the acceptance of a purchase or a gift or a bequest.⁷

Sharikat al-ʿuqūd, may be concluded with regard to money and goods. These two

sharikat al-milk is characterised as *jabriyyah* (involuntary). For example see *Fatḥ Q.*, Vol. VI, pp. 153 - 154.

⁴ It is also called contractual partnership or mercantile partnership. See for example Kāsānī, Vol. VI, p. 57; *Mabsūṭ*, Vol. XI, p. 151; *Fatḥ Q.*, Vol. V, p. 3; Ḥaṣḥ A., Vol. III, p. 364; Jazirī, Vol. III, p. 83; see also Abdur Rahim, *The Principles of Muhammadan Jurisprudence*, Lahore, 1911, p. 323.

⁵ Udovitch, *Partnership*, p. 24; *Idem*, "The Merchant in Medieval Islam", in Ann K. S. Lambton, *Theory and Practice in Medieval Persian Government*, London, 1980, p. 122.

⁶ Al-Qudūri, Aḥmad b. Muḥammad b. Aḥmad b. Jaʿfar (d. 428/1037), *Mukhtaṣar*, Istanbul, 1319/1901.

⁷ *Mabsūṭ*, Vol. XI, p. 151; Cf. Kāsānī, Vol. VI, pp. 56, 65 - 66; *Hidāyah*, Vol. II, p. 296; Coulson, *Commercial Law*, pp. 23 - 24 opines that there are two types of *al-sharikah*; *sharikat al-amwāl* (partnership in property) and *sharikah al-ʿmāl* (partnership in work). In partnership in property, the partners contribute their work or expertise, but if the contributions involve a different nature, such a partnership is not recognised by Islamic Jurisprudence.

are considered to be property as the capital in any business transactions or work or with regard to two or to all three of these values.⁸

Discussions of partnership in all schools except the Shāfi'ī, while covering the the topics of joint ownership and common property, are concerned almost entirely with commercial forms of partnership (*sharikat al-ʿuqūd*). In this regard, Udovitch states:

The primary connotation of the term *shirkah* or *sharikah* for the Hanafī and Mālikī jurists was a contractual partnership involving joint investment and joint sharing of profits and risks. Proprietary partnership appears almost as a peripheral notion The essence of proprietary partnership is common ownership of property.⁹

The basis of a contract of partnership consists of offer (*ījāb*) and acceptance (*qabūl*), express or implied. For example, A informs B that he has become his partner whereby they will carry on business with a certain amount of capital. B agrees. An express partnership has been formed by offer and acceptance. If one gives to the other £1000 and requests the other to give £1000 also and buy certain property, and the other does so, a partnership has been formed by this implied acceptance.¹⁰

According to Sayyid Sābiq,¹¹ the origin of the concept of *sharikah* is from the verse : "But if more than two, they share (*shurakā'*) in a third".¹² In its strict

⁸ Kāsānī, Vol. VI, pp. 56 - 57; *Muḥallā*, Vol. VIII, pp. 123 - 124.

⁹ Udovitch, *Partnership*, p. 24.

¹⁰ Cf. *Maj. ʿAdliyyah*, art. 1330.

¹¹ Sābiq, *Fiqh al-Sunnah*, Vol. III, p. 258.

¹² Q, 4 : 12.

meaning, the word *sharikah* from the above verse, connotes partnership which implies equalization (*taswiyah*) in rights.¹³ Al-Ṭabarī, however, held that the above word implies *khulṭah*, literally means "mixing (of the investment)".¹⁴

Khulṭah is the common sense of the word *sharikah* which implies one in which the contractors offer the various services in equal or unequal shares and partake in profit or loss in proportion to their investment.¹⁵

1.2. Legitimacy of *Sharikah*

According to some jurists,¹⁶ the legal theory of *sharikah* is based on the verse of the Qur'ān which reads : "Truly many are the partners (in business) (*khulaṭā'*) who wrong each other; not so do those who believe and work deeds of righteousness, and how few are they?"¹⁷ In this verse, the word *al-khulaṭā'* refers to associates in a partnership¹⁸ who have the right of equal co-ownership.

Khulṭah is a partnership which is different from the conventional type of

¹³ *Mabsūṭ*, Vol. XI, pp. 169 - 170.

¹⁴ al-Ṭabarī, *Jāmi' al-Bayān*, Vol. XX, pp. 178 - 179; According to Lane, *khulṭah* is the state of two properties being so mixed that they cannot be separated. See Lane, Vol. I, p. 789; See also S. D. Goitein, "Commercial and Family Partnership in the countries of Medieval Islam", *IS*, Vol. III(3), 1964, pp. 317 - 318.

¹⁵ S. D. Goitein (1964), *op. cit.*, pp. 317 - 318.

¹⁶ e.g. Ibn Qudāmah (*Mughnī*, Vol. III, p. 3), Sayyid Sābiq (*Fiqh al-Sunnah*, Vol. III, p. 258), Wahbah al-Zuhaylī (Wahbah, Vol. IV, p. 793). Cf. *M. Muḥṭāj*, Vol. II, p. 211; *Mabsūṭ*, Vol. XI, p. 151; al-Nawawī, *Rawdat al-Ṭālibin*, Vol. III, p. 503.

¹⁷ Q, 38 : 24.

¹⁸ al-Ṭabarī, Vol. XXIII, p. 145.

partnership. In *khulṭah*, every associate or partner contributes his respective capital, for instance, livestock (*māshiyah*) and one of the partners works individually or they amalgamate their capital and work together to gain profits. The distribution of profits in this partnership is on the basis of the capital and the work which each individual partner has invested and the profits which he has made.¹⁹ This practice is supported by a Tradition from the Prophet :

.....And there is a share between two partners (*khalīṭayn*) in a co-ownership, and whenever they withdraw from partnership, their properties are to be divided equally (in accordance with their respective participation).²⁰

The acceptability of the practice of *sharikah* is found in several Traditions, among which are :

1. The Prophet is reported to have said:

God says : I am the third partner (*thālith al-sharikayn*) (i. e. I will bless the two partners) as long as each of the two partners does not betray his partners; but when one of them becomes dishonest, I will leave both of them.²¹

2. The Prophet is reported to have said:

A partner has a greater right of pre-emption (*shuf'ah*) than the owner of an adjoining property.²²

3. It is reported that the Prophet decreed the right of pre-emption for partners,

¹⁹ Muzanī, Vol. VIII, pp. 138 - 139; Ibn al-Athīr, vol. II, p. 63; Qasṭallānī, *Irshād al-Sārī li Sharḥ Ṣaḥīḥ al-Bukhārī*, Vol. IV, p. 284; Cf. *Lisān*, Vol. VII, p. 295; *Tāj*, Vol. XIX, p. 259.

²⁰ Muzanī, Vol. VIII, p. 138; See also al-Ṭabarī, *Jāmi' al-Bayān*, Vol. XV, p. 179.

²¹ Abū Dāwūd, *Sunan*, Vol. III, p. 348; al-Dāraqutnī, *Sunan*, Vol. III, p. 28 (no. 2911); *Awfār*, Vol V, p. 390.

²² *Muw. Sh.*, p. 305.

in the case of property which had not been divided up.²³

4. The Prophet is reported to have said in relation to pre-emption:

Whoever has a share in a piece of land or houses, is not permitted to sell it until his partner (*sharikuh*) gives his permission. If the partner wants, he can take (buy) it, and if he wishes, he can leave it, i.e., he can allow it to be sold to others.²⁴

5. The Prophet is reported to have said:

The partner or co-owner (*sharik*) is the one with the right of pre-emption (*shāfi'*) in everything.²⁵

The above traditions apply to a partner who is in joint or collective ownership. These accounts indicate that the Qur'an and the Prophet approved of the concept of commercial partnership (*sharikat al-^cuqūd*), and sanctioned it and its practice. He himself had engaged in commercial partnership before his prophethood.²⁶

There are various reports that show that *sharikah* was widely practised in pre-Islamic times. It was reported that Nawfal b. al-Hārith b. ^cAbd al-Muṭṭalib became the partner of al-^cAbbās b. ^cAbd al-Muṭṭalib in an unlimited partnership (*sharikat al-mufāwadah*).²⁷ Sayfī b. ^cĀ'idh became a partner of the Prophet before his

²³ Muw. Y., p.466; Cf. Dāwūd, *Sunan*, Vol. III, p. 387 (no. 3514).

²⁴ Muslim, Vol. IIIA, p. 63; Nasā'i, *Sunan*, Vol. VII, p. 320; See also al-Dārimī, *Sunan*, Vol. II, p. 188; Muḥallā, Vol. IX, p. 606.

²⁵ Muḥallā, Vol. IX, p. 606..

²⁶ Ibn Hishām, *al-Sirah al-Nabawiyyah*, Vol. II, p. 254; *Iṣābah*, Vol. II, p. 8; Cf. *Awjār*, Vol. V, pp. 390 - 391; *Fath Q.*, Vol. VI, p. 153.

²⁷ *Mufaṣṣal*, Vol. III, p. 407.

prophethood in the trade in the Yemen.²⁸ Al-Sā'ib b. al-Hārith b. Sābirah was also a partner of the Prophet in the pre-Islamic period in Mecca.²⁹

It was reported that the merchants of the Yemen used to go to Mecca and Medina and that they engaged in such partnerships in pre-Islamic times.³⁰ It was also reported that al-ʿAbbās b. Mirdās al-Sulamī was the partner of Harb b. Umayyyah³¹ and al-ʿAbbās b. Anas was a partner of ʿAbd Allāh b. ʿAbd al-Muṭṭalib (the father of the Prophet) in pre-Islamic times.³²

From the historical evidence, it would seem that the Arabs used to write down their agreements of partnership in business transactions in the form of written documents which stated the agreed terms of their partnerships. Such partnerships took the form of *sharikah* and *muḍārabah*. In the latter case, the capital would be provided by one or more partners, and the work would be carried out by another. The distribution of profits or losses from the business activities would be incurred among them in accordance with the agreement. Such partnership was normally undertaken by traders from Mecca to the Yemen and al-Shām (Syria).³³

²⁸ Abū ʿUmar Yūsuf b. ʿAbd Allāh b. Muḥammad, Ibn ʿAbd al-Barr (d. 463 A. H.), *Kitāb al-Istīʿāb fī Maʿrifat al-Aṣḥāb*, on the margin of *Iṣābah*, Vol. II, p. 101.

²⁹ The Prophet praised his sincerity and easy disposition in their partnership. See : Ibn Hishām, *Al-Sīrah al-Nabawīyyah*, Vol. II, p. 254; *Iṣābah*, Vol. II, p.8.

³⁰ *Mufaṣṣal*, Vol. II, pp. 407 - 408; Cf. Mahmood Ibrahim, "Social and Economic Conditions in Pre-Islamic Mecca", *IJMES*, Vol. XIV, 1982, pp. 344 - 345.

³¹ *Iṣābah*, Vol. II, p.172 (4511).

³² *Ibid.*, Vol. II, p. 270 (4505).

³³ *Mufaṣṣal*, Vol. VII, p. 406.

From the above discussion, it may be concluded that there is a difference between *sharikah* in general and *muḍārabah*. In the case of partnership based on *sharikah*, capital would be provided by one or more partners, whether in the form of immovable property or cash. The profits and losses would be divided among them in accordance with the agreement.³⁴ In a *muḍārabah* partnership, however, any loss would be shouldered by the owner of the capital (*rabb al-māl*; *ṣāhib al-māl*) and not by the agent-manager,³⁵ because he has no capital in the partnership.

1.3. Classification of Commercial Partnership (*Sharikat al-ʿUqūd*)

Commercial partnership in Islamic law is usually divided according to the subject of the partnership, the subject of partnership being capital or labour or credit, into three kinds, namely;

1. *sharikat al-amwāl* (partnership in capital)
2. *sharikat al-ʿmāl* (partnership in labour)
3. *sharikat al-wujūh* (partnership in credit).³⁶

Sharikat al-amwāl is further classified into two types, i.e. *sharikat al-mufāwāḍah*

³⁴ *Muḥallā*, Vol. VIII, p. 124.

³⁵ *Mabsūf*, Vol. XI, pp. 156 - 157; Vol. XXII, pp. 17 - 18; *Bidāyah*, Vol. II, p.303; *M. Muḥtāj*, Vol. II, p. 309; Zurqānī, Vol. III, p. 158; *Mughnī*, Vol. V, pp. 31 - 32 and 38; al-Nawawī, *al-Majmūʿ*, Vol. IX, pp. 64 - 65; S. Mizān, Vol. II, p. 92; *Muḥallā*, Vol. VIII, p. 126; Sahnūn, Vol. XII, p. 109; N. Minhāj, pp. 64 - 65; *Wajiz*, Vol. I, p. 187; Schacht, *Introduction*, pp. 156 - 157; J. A. Wakin, *The Function of Documents in Islamic Law*, Albany, 1972, pp. 130 131; *Idem*, "Muḍārabah", in : *EI(2)*, Vol. VII, 1990, pp. 284 - 285; See also : A. A. Hasan, "Al-Muḍārabah (Dormant Partnership) and Its Identical Islamic Partnerships in Early Islam", *HI*, Vol. XII (2), 1989, pp. 11 - 38.

³⁶ *Fath Q.*, Vol. VI, p. 155; Ibn Juzayy, *al-Qawānīn al-Fiqhiyyah*, p. 244. See also *Maj. ʿAdliyyah*, arts. 1331 - 1332.

and *sharikat al-ʿinān*.

1.3.1. *Sharikat al-Mufāwadah*³⁷ (universal or unlimited investment partnership)

(a) Definition

Mufāwadah has a literal meaning of *musāwāt* (equality).³⁸ The legal term of *mufāwadah* is derived from *al-tafwīḍ* (delegation of authority),³⁹ for each partner empowers his colleague to act freely with the entire partnership's capital.⁴⁰

Sharikat al-mufāwadah may be best translated as a universal or unlimited investment partnership.⁴¹ Technically, *mufāwadah* partnership is a partnership which is essentially based on three features; complete equality of the partners in all aspects,

³⁷ This type of partnership is strongly disapproved of by al-Shāfiʿī mainly because the equality it advocates cannot be implemented in practice. Besides that, there is a possibility that one partner might be able to drive an unjustified and undeserved benefit from the extrapartnership income involving, for example, the discovery by the other partners of a treasure trove or their receiving a gift. Both sources of wealth have no connection with the partnership, as such, and should not become part of the social capital, see : Umm, Vol. III, p. 306; *M. Muḥtāj*, Vol. II, p. 215; see also : *Minhāj N.*, pp. 132 - 133; Shirāzi, Vol. I, p. 245; It is disowned by Abū Hanifah and recognised by Abū Yūsuf, al-Shaybānī and Ibn Abī Laylā. See : *Mabsūṭ*, Vol. XI, p. 153; W. Heffening, "Sharika", in : *El(I)*, Vol. IV, 1913 - 1934, p. 381.

³⁸ See for example *Lisān*, Vol. VII, p. 210; *Mabsūṭ*, Vol. XI, p. 152; Kāsānī, Vol. VI, p. 58; *Faṭḥ Q.*, Vol. VI, p. 156.

³⁹ See refs. no. 37; *Faṭḥ Q.*, Vol. VI, p. 156.

⁴⁰ Lane, Vol. II, p. 2459; W. Heffening, *op. cit.*, p. 381; Udovitch, *Partnership*, p. 44; Al-Sarakhsi's neat definition of *mufāwadah* states that it is derived from *tafwiḍ* (delegation of authority), for each partner empowers his colleague to act freely with the entire partnership's capital. It has also been said that its derivation is from the idea of dispersal, as it is said : "The water overflowed (*fāḍa*)", meaning that it spread out and dispersed or "the bounty is spread out (*yastafīḍu*)", meaning, it is distributed widely, since this contract is based upon the dispersal of authority for all the transactions. It has also been associated with *fawḍa*, which means equality of investment and profit, and therefore it is called *mufāwadah*. See : *Mabsūṭ*, Vol. XI, p. 152; see also : Lane, Vol. II, p. 2459.

⁴¹ Ibn al-Athīr, Vol. III, p. 479; *Tāj*, Vol. XVIII, p. 479; Lane, Vol. II, p. 2459; Udovitch, *Partnership*, p. 40; Cf. Haim Gerber, "The Muslim Law of Partnership in Ottoman Court Records", *SI*, Vol. 53, pp. 113 - 114.

the inclusion of all trade activities within its scope, and the mutual agency and surety of the partners.⁴² Complete equality in all financial matters is an indispensable condition of the unlimited partnership. Any deviation from this value, whether in respect of each partner's contribution to the joint capital or to the share of profits and losses is regarded as making this partnership invalid.⁴³

In Mālikī doctrine, the *mufāwadah* is transformed into an entirely different institution. It connotes a general mandate partnership, i. e. an arrangement in which each party confers upon his colleague full authority to dispose of their joint capital in any manner intended to benefit their association. The emphasis is on the *tafwīd*, i. e., on the delegation of discretionary authority to conduct trade with each other's capital. Each partner is his colleague's agent and can act in all commercial matters with respect to his own and his colleague's property without the latter's approval. Any obligation incurred on behalf of the partnership toward a third party by one of the partner can be claimed in full from any of the other partners. Each of them is liable for any obligation undertaken by his colleagues in connection with their work.⁴⁴

From the above discussion, it can be said that according to the Mālikī concept of *mufāwadah* partnership, the implication of the term *mufāwadah* for partnership is confined to the nature of the relationship between the partners and does not extend,

⁴² *Mabsūt*, Vol. XI, p. 152; *Hidāyah*, Vol. III, p. 4; *Ṣaḥnūn*, Vol. XII, p. 70; *Mughnī*, Vol. V, p. 30; Lane, Vol. II, p. 2459.

⁴³ Muhammad al-Shaybānī, "*Kitāb al-Aṣl, Kitāb al-Sharikah*", fol. 68b. II, pp. 15 - 17; The only dissenting view is that of Ibn Abī Laylā who holds that a slight inequality in the investment does not invalidate the *mufāwadah* contract. This view is probably due to a difference in construction of the term *mufāwadah*. See Abū Yūsūf, *Ikhtilāf Abī Hanīfah wa Ibn Abī Laylā*, Cairo, 1938, p. 93; see also *Fatḥ Q.*, Vol. VI, pp. 156 - 157.

⁴⁴ *Ṣaḥnūn*, Vol. XII, p. 68 - 70; *Bidāyah*, Vol. II, pp. 191 - 192; Ibn Juzayy, *op cit.*, p. 244; see also 'Alī al-Khafīf, *Al-Sharikāt fī al-Fiqh al-Islāmī*, 1962, p. 34.

as it does in Hanafī law, to any other aspect of the association. Moreover, according to the Mālikī concept, there is no requirement for equality in the personal and financial status of the respective partner; nor does the Mālikī *mufāwadah* insist on the inclusion of all eligible capital within the partnership.⁴⁵

(b) Legitimacy of *mufāwadah* partnership.

The legitimacy of a *mufāwadah* partnership is based on modification of strict legal standards by means of the application of juristic preference (*istihsān*).⁴⁶ The reason given for the exercise of juristic preference is the Prophet's statement : "Fāwidū (enter into partnership by reciprocity), for it is most conducive to prosperity (*barakah*)".⁴⁷ Also, men have had transactions together in this manner with no person forbidding them. Moreover, the exercise of juristic preference is followed in permitting the *mufāwadah* partnership because of "the custom of the merchants" (*‘ādat al-tujjār*) or "the need of the merchants for it".⁴⁸

For this reason :

Each partner has the right to deposit goods belonging to the partnership; for depositing is one of the customary practices of merchants (*‘ādat al-tujjār*). It

⁴⁵ Saḥnūn, Vol. XII, p. 70; *Bidāyah*, Vol. II, pp. 191- 192.

⁴⁶ It is said that if *mufāwadah* partnership is based on analogy (*qiyās*), it would not be permissible. The reason given is that on the basis of analogy (*qiyās*), this form of partnership would comprehend the power of *wakālah* (agency) with respect to unknown subjects and the obligation of *kafālah* (surety) with respect to a thing undefined, and each of this individually is not permissible. See for example *Hidāyah*, Vol. III, p. 4

⁴⁷ *Mabsūṭ*, Vol. XI, p. 153; *Hidāyah*, Vol. III, p. 4; *Fath Q.*, Vol. VI, p. 157.

⁴⁸ *Mabsūṭ*, Vol. XI, p. 80. The notion of *‘ādat al-tujjār* has also been used as an argument to justify some practices in *mufāwadah* contracts. Those cases are like the case of pledge (*al-rahn*) which is governed by the same rules as those of deposits, the case of loan whether in form of *‘āriyah* (loan for use) or *qard* (loan for fungible commodities), practice of purchase, sale and debt and expenses for execution of *mufāwadah* operations. See Udovitch, *Partnership*, pp. 104 - 112.

is also one of the necessities of trade and one which is indispensable to the merchants. He has need of this transaction in many situations which are likely to occur. Since a partner has the right to pay a fee to have a deposit taken care of, he has this right when no compensation is involved.⁴⁹

(c) Equality of *mufawadah* partnership.

i. Equality in person (personal status)

According to Hanafī jurists equality of person in all respects is one of the prerequisites for a valid *mufawadah* partnership. This applies not only to the amount of each partner's investment and to the division of profits and losses between them, but also to the personal status of the partners. They also hold that a *mufawadah* partnership which is based on the idea of mutual surety is valid only if it is contracted between two free people.⁵⁰

In this regard, the slave, the *mukātab* slave and minors even with the permission of their parents or guardian cannot make a *mufawadah* partnership with a freeman, since they do not possess complete freedom of action in commercial matters.⁵¹ Moreover, a slave cannot provide surety for another person, nor is he fully responsible for his own action as the master can circumscribe the rights of his slave.⁵² A universal partnership between a freeman and those category of people would create

⁴⁹ Kāsānī, Vol. VI, p. 68.

⁵⁰ *Mabsūf*, Vol. XI, p. 198; *Hidāyah*, Vol. III, p. 4; *Fath Q.*, Vol. VI, pp. 158 - 159.

⁵¹ *Mabsūf*, Vol. XI, p. 198; *Hidāyah*, Vol. III, p. 4.

⁵² *Mabsūf*, Vol. XI, p. 198; *Fath Q.*, Vol. VI, p. 159.

severe inequality, for the former would be liable for his own and the latter's actions.⁵³

Abū Yūsuf and al-Shaybānī, two disciples of Abū Hanīfah, however, held that a *mufāwadah* partnership contracted between two *mudabbār* slaves (who will automatically attain their freedom upon their master's death) is valid.⁵⁴

The demand for equality of person between two partners in a *mufāwadah* (universal) partnership extends to religious affiliation as well. The *mufāwadah* partnership, covering as it does, all commercial transactions of the partners, yet, certain business transactions permissible for a non-Muslim,⁵⁵ may not be so for a Muslim, thus disqualifying the latter from full participation in a "mixed *mufāwadah*".⁵⁶

Although Abū Yūsuf permits a *mufāwadah* partnership between a Muslim and a *dhimmī*, he considers it a *makrūh*⁵⁷ arrangement, that is, disapproved or reprehensible but not forbidden. He justifies his idea on the basis of the elements of mutual surety and mutual agency, of which a *dhimmī* like a Muslim is capable.⁵⁸

⁵³ *Mabsūt*, Vol. XI, p. 198; *Fatḥ Q.*, Vol. VI, pp. 160 - 161.

⁵⁴ Al-Shaybānī, "*Kitāb al-Aṣl, Kitāb al-Sharikah*", Fol. 68b, ll. 12 - 14; *Idem, al-Makhārij fī al-Hiyal*, p. 59.

⁵⁵ This includes a Christian, Jew, Zoroastrian and *dhimmī*.

⁵⁶ *Mabsūt*, Vol. XI, pp. 196 - 197.

⁵⁷ *Makrūh* (disapproved) is a demand of the lawgiver which requires the *mukallaf* to avoid something, but not in strictly prohibitory terms. Since *makrūh* does not constitute a binding law, it is merely said that omitting something which is *makrūh* is preferable to committing it. See for example 'Abd al-Wahhāb Khallāf, *Ilm Uṣūl al-Fiqh*. Kuwait, 1978, p. 114; Abū Zahrah, *Uṣūl al-Fiqh*. Cairo, 1958, p. 36; Aghnides, p. 89; Coulson, *History*, p. 84.

⁵⁸ *Mabsūt*, Vol. XI, pp. 196 - 197; Kāsānī, Vol. VI, p. 61.

On the other hand, Mālikī law holds that any legally competent person capable of disposition of property (*taṣarruf*) and of conferring a mandate can be a partner in a *mufāwadah* partnership contract. This requirement excludes minors, mentally incompetent people and slaves acting without their master's authorization. Slaves upon whom their masters have conferred the right to engage in trade (*al-ma'dhūn lahu fī al-tijārah*) are, however, fully eligible to enter into partnership contracts.⁵⁹

Mālikī law also holds the opinion that a partnership between a Muslim and a non-Muslim is valid on condition that the former supervises all the commercial transactions. This requirement is, of course, intended to prevent any usurious transaction or any trading in commodities which are forbidden to a Muslim.⁶⁰

This means that Mālikī law does not demand equality in personal status as a prerequisite for a valid *mufāwadah* partnership. In short, *mufāwadah* partnerships are, according to Mālikī law, permissible between any legally competent Muslim, male or female, as well as slaves who are authorized to engage in trade and, under the proper condition of supervision, between those and a non-Muslim.

⁵⁹ Ṣaḥnūn, Vol. XII, p. 70.

⁶⁰ *Ibid.*

ii. Equality of investment, profit and loss

According to Hanafī law, the partners in a *mufāwadah* partnership must share equally in their investment (capital), profit and loss.⁶¹ Any deviation from this rule, whether in respect to each partner's contribution to the joint capital or to the share of profits and losses assigned to him, immediately renders the *mufāwadah* partnership invalid.⁶² Thus to constitute a *mufāwadah* partnership, each partner must invest an equal amount of joint capital and accept equal distribution of profit and loss in the venture.

In contrast to the above principle, Mālīkī law does not require complete equality of investment (capital), profits and loss in a *mufāwadah* partnership. The distribution of profits and loss is in accordance with the partner's respective capital.⁶³

Investment (capital)

All Muslim legal authorities are in full agreement concerning the acceptability

⁶¹ Al-Shaybānī, "*Kitāb al-Aṣl, Kitāb al-Sharikah*", fol. 68b, II. 15 - 17; *Mabsūṭ*, Vol. XI, p. 177.

⁶² *Mabsūṭ*, Vol. XI, p. 177; The requirement of equality of persons and of investment is best summed up by al-Shaybānī himself: "A *mufāwadah* partnership can be contracted only by two free muslims who are both of age, or between two *dhimmis*. It cannot be contracted between a Muslim and a *dhimmi*. A *mufāwadah* can be contracted only if the capital of each partner is equal. If one of the partners comes into an inheritance or receives a gift in the form of goods, it belongs exclusively to that partner and it does not invalidate the *mufāwadah*. If, however, he inherits or receives *dirhams* or *dinārs*, the *mufāwadah* is invalidated". *Al-Jāmi' al-Ṣaghir*, Cairo, 1302/1884, p. 10

⁶³ Saḥnūn, Vol. XII, p. 45. Mālik said : "Loss is in accordance with their respective capital, and profit is in accordance with their respective capital", *Ibid.*, pp. 59 - 60.

of gold and silver (*dīnār* and *dirham*) currency for partnership investment.⁶⁴ The legal problems which do arise in this regard are the acceptance of copper coins as capital in the *mufāwadah* partnership. The question of a partnership with copper coins (*fulūs*)⁶⁵ as capital in the partnership investment is not treated in Mālikī law. For a *muḍārabah* partnership, however, investment in copper coins is absolutely disqualified.⁶⁶ The wide margin between the intrinsic and the face value of copper coins and the fact that their value and acceptance varied widely from place to place, caused uneasiness among the jurists and cast doubt on the validity of their use for partnership and other investment.⁶⁷

In this regard, Abū Hanīfah and Abū Yūsuf deny copper coins the status of currency because on the whole they are not completely interchangeable as are standard gold and silver coins, but resemble commodities in that each individual copper coin or type of coin may differ in value and acceptance from time to time and place to place.⁶⁸ If they are permitted as capital in *mufāwadah* partnership, this will lead to uncertainty as to the amount of each partner's capital at the time of the division of profit.⁶⁹

⁶⁴ Kāsānī, Vol. VI, pp. 60 - 61; *Mabsūṭ*, Vol. XI, pp. 159 - 160 and 178; *Bidāyah*, II, p. 190; *Ṣaḥnūn*, Vol. XII, pp. 63 - 65; *Minhāj* N., p. 132; *Mughnī*, Vol. V, pp. 16 - 18; *Fath Q.*, Vol. VI, p. 168; *Hidāyah*, Vol. III, p. 6; al-Qayrawānī, *al-Risālah*, p. 476.

⁶⁵ Singular : *fals*. The fals was a token coin and was never recognized as legal tender comparable to gold and silver. See A. L. Udovitch, "*Fals*", *El(2)*, Vol. II, 1965, pp. 768 - 769.

⁶⁶ *Ṣaḥnūn*, Vol. XII, p. 65; *Fath Q.*, Vol. VI, pp. 168 - 169.

⁶⁷ Kāsānī, Vol. VI, pp. 59 - 60; *Mabsūṭ*, Vol. XI, p. 160.

⁶⁸ Kāsānī, Vol. VI, pp. 59 - 60; *Fath Q.*, Vol. VI, p. 168.

⁶⁹ *Mabsūṭ*, Vol. XI, p. 160; *Fath Q.*, Vol. VI, p. 169.

Al-Shaybānī, however, holds the view that as long as copper coins (*fulūs*) are in circulation, they are in the category of an absolute currency. In his view, they are suitable for capital in partnership investment like all other absolute currency, viz. *dīnārs* (gold) and *dirhams* (silver).⁷⁰

Mālikī law does not permit a cash (*dīnār* or *dirham*) partnership which has the element of *ṣarf* (exchange). This contract does not arise when each partner's investment consists of coins of the same metal, but when they are of varying types or coins of different metals.⁷¹ For example, one partner invests only *dīnārs* and the other only *dirhams*. These two types of coins have a different exchange rate and if they form a partnership dividing the work and profit equally between them, this will mean that the capital of one of them may exceed that of his partner. Furthermore, a partnership in which the capital of one partner is greater than that of his partner is not permissible unless the profit and work are divided according to their respective shares in the joint capital.⁷²

Of the schools of Islamic law, only the Mālikī school recognizes the validity of a partnership investment in the form of goods.⁷³ All licit goods are eligible to become part of the joint capital of a partnership.⁷⁴ The only goods which Mālikī law does not countenance for the formation of a partnership are foodstuffs that are measurable or

⁷⁰ *Ibid*; *Kāṣānī*, Vol. VI, pp. 59 - 60; see also *Fatḥ Q.*, Vol. VI, p. 168.

⁷¹ *Sahnūn*, Vol. XII, pp. 62 - 63; Cf. F. H. Ruxton, *Maliki Law*, London, 1916, p. 159.

⁷² *Sahnūn*, Vol. XII, pp. 63 - 64; *Bidāyah*, Vol. II, p. 191.

⁷³ *Sahnūn*, Vol. XII, pp. 54 - 55.

⁷⁴ *Ibid.*, p. 56.

weighable.⁷⁵ According to them, this type of partnership is formed on the basis of the value of each partner's contribution (merchandise) and on condition that each of them will share in the work, profit and loss in accordance with his respective capital's value.⁷⁶

Mālik refuses to accept the validity of a partnership in which each partner's capital consists of foodstuffs of the same type, quality and quantity.⁷⁷ Ibn Qāsim, a disciple of Mālik, however, considers this type of arrangement should be allowed if it is formed on the basis of weight of foodstuffs, and not according to their value.⁷⁸

Concerning the *mufāwadah* partners, al-Kāsānī, the Hanafī jurist, wrote: "They are in reality two persons, but from the standpoint of the principles of commerce, they are like a single person".⁷⁹ This means that all the eligible capital of the partners, as well as all their commercial activities (transactions), is included the *mufāwadah* partnership.⁸⁰ By virtue of this inclusiveness, each partner is fully liable for the actions and commitments of the other in all commercial matters. The claims of third parties are thus actionable against either partner; and conversely, either partner can make a claim against a third party, regardless of whether or not he was actually involved in the transactions which gave rise to that claim. As far as third parties are

⁷⁵ This applies if the investments are of different types of foodstuffs, even if they are of equal value. In their view, the status of these goods in sale approaches that of *ṣarf*. *Ibid.*, p. 56.

⁷⁶ *Ibid.*, pp. 54 - 55.

⁷⁷ *Ibid.*, p. 58; al-Qayrawānī, *al-Risālah*, p. 476.

⁷⁸ Ṣaḥnūn, Vol. XII, p. 58.

⁷⁹ Kāsānī, Vol. VI, p. 73; *Cf. Mabsūṭ*, Vol. XI, pp. 174 and 190.

⁸⁰ Kāsānī, Vol. VI, p. 62.

concerned, dealing with any of the *mufāwadah* partners is equivalent to dealing with the partnership firm.⁸¹

The relationship between the partners themselves and between them and third parties in a *mufāwadah* partnership can be summarized as follows: in all partnership, including the *mufāwadah*, the liability is unlimited. In *mufāwadah* partnership liability toward third parties is both several and joint.⁸² A liability is said to be joint and several when creditors may sue one or more of the parties to such liability, either separately or all together, at his discretion.⁸³

Liability in the *mufāwadah*, as well as the rights, privileges and duties of the partners with respect to each other is in accordance to the two fundamental legal principles upon which this partnership is based. The first is mutual agency (*al-wakālah*) which in Hanafī law is the basis of all forms of contractual partnership. This means that, within the scope of their joint undertaking, each partner is considered to be an agent of his colleague.⁸⁴ The second principle and the one which is unique to the *mufāwadah* in Hanafī law is that of mutual surety (*kafālah*). According to this principle, a partner is not only his colleague's agent, but also guarantor (*kafīl*) for all his colleague's actions connected with the partnership.⁸⁵

⁸¹ *Ibid.*

⁸² Kāsānī, Vol. VI, pp. 60 - 61; Ḥash A., Vol. III, p. 369; W. Heffening, *op. cit.*, p. 181.

⁸³ See Henry Campbell Black, *Black's Dictionary of Law*, St. Paul, 1933, p. 1020.

⁸⁴ Kāsānī, Vol. VI, pp. 60 - 61; Ḥash A., Vol. III, p. 369; *Hidāyah*, Vol. III, p. 4 ; Cf W. Heffening, *op. cit.*, p. 381.

⁸⁵ See refs. no. 82, above.

According to Mālīkī law, however, members of a *mufāwadah* partnership are presumed to have discretionary powers in the administration of their capital. They delegate to each other the authority to transact business with the common capital which is recognized as a usual part of trade.⁸⁶ Each partner can act independently in the name of the partnership without exposing himself to any liability greater than that which would normally be his share.⁸⁷

(d) Conduct of *mufāwadah* partnership.

i. Deposits and pledges in *mufāwadah*

A deposit⁸⁸ is classified as an *amānah* and involves no payment of a fee or any other compensation to either party.⁸⁹ A partner in a *mufāwadah* partnership would place money or goods in the custody or safeguarding of the depository, whose task is to safeguard them. The ownership of property and risks remains with the depositor. Any loss of or damage to deposited partnership property is borne by the partnership, and no individual liability attaches to the partner who arranged for the deposit. Either

⁸⁶ Saḥnūn, Vol. XII, p. 75.

⁸⁷ *Ibid.*

⁸⁸ A deposit (*wadī'ah*) is a contract (fiduciary relationship or trusteeship) (*al-amānah*) whereby a property is remitted to a trustee (depository). The proprietor of the thing (depositor) to be kept, often gratuitously, by the latter, and the latter returns to its owner on demand. The property so remitted is held in trust (*qabḍ amānah*). A trustee (depository) is liable for the loss or misappropriation in that property only if he commits an act of transgression (*ta'addi*) such as using the property for his own use or negligence (*tafrif*) such as storing the property in an unsafe place from where it was stolen. See *Mughnī*, Vol. VI, p. 382; *Mabsūt*, Vol. XI, p. 109; *M. Muḥtaj*, Vol. III, p. 79; al-Ramlī, *Nihāyah al-Muḥtāj*, Vol. V, p. 87; *Fath Q.*, Vol. VIII, p. 485; *Ḥaṣh A.*, Vol. IV, p. 515; *Umm*, Vol. IV, p. 142; *Muḥallā*, Vol. VIII, p. 277; *Wajiz*, Vol. I, pp. 84 - 87; *Shirāzī*, Vol. I, p. 500; Schacht, *Introduction*, p. 157; Lane, Vol. II, p. 3051; Otto Spies, "Wadia", *El(1)*, Vol. IV, 1934, pp. 1079 - 1081.

⁸⁹ *Mabsūt*, Vol. XI, p. 109; *Muḥallā*, Vol. VIII, p. 277; *Umm*, Vol. IV, p. 142; *Shirāzī*, Vol. I, p. 501; al-Nawawī, *Rawḍāt al-Tālibin*, Vol. V, p. 289; Cf. Schacht, *Introduction*, p. 157.

partner is entitled to retrieve the deposit and either one can bring the suit against the depository in the case of the latter's negligence.⁹⁰

The depository could be held liable only in the case of negligence and all obligations are extinguished with the return of the deposit to the depositor.⁹¹

The use of pledges⁹² (*rahn*) on behalf of partnership transactions is governed by the same rules as those of deposits. Both partners have the right to give a pledge as guarantee of payment for credit extended to the partnership or take a pledge as security for payment of a debt owed to the partnership.⁹³ In short, in either case, both partners are equally bound by the contract.

According to Hanafī law, a partner in a *mufāwadah* partnership can also entrust money or goods belonging to the partnership as a *biḍā'ah*⁹⁴ to another person within

⁹⁰ Shaybānī, *op. cit.*, fol. 65b, l. 16 - fol. 66b, l. 4.

⁹¹ Kāsānī, Vol. VI, p. 68.

⁹² Pledge (*rahn*) or security means to pledge or lodge a real or corporated property of material value in accordance with the law as security for a debt, so as to make it possible for the creditor to regain the debt or some portion of the goods or property. (Kāsānī, Vol. VI, p. 135; al-Qurṭubī, *al-Jāmi' li Ahkām al-Qur'ān*, Vol. III, p. 409; Schacht, *Introduction*, p. 139; J. Schacht, "Rahn", *El(I)*, Vol. III, 1934, p. 1105). The Prophet is reported to have bought some foodstuff on credit for a limited period and to have given his armour as a security for it. (Abū Hanifah, *Musnad*, p. 164; Ibn Hanbal, *Musnad*, III, p. 355; *Umm*, III, pp. 141 - 142).

⁹³ *Ibid.*

⁹⁴ This practice can be illustrated by the example of a merchant (*the mubdi'*), who is unable personally to attend a business affair, hands over some of his property to another party (*the mustabdi'*: the one who receives it), so that the latter will take care of it for him. Upon completion of his task, the outside party, without receiving any commission, profit or compensation in any other form, returns the proceeds of the transaction to the merchant whose bidding he has done. See *Mabsūf*, Vol. XI, p. 181; Kāsānī, Vol. VI, p. 68. It might best be described as a type of quasi-agency. S. D. Goiten has described this practice as "informal commercial cooperation". See *A Mediterranean Society, the Jewish Communities of the Arab World as Portrayed in the Documents of the Cairo Geniza*, Vol. I, *Economic Foundations*, Berkeley and Los Angeles, 1967, pp. 164 - 169.

the bounds of fidelity (*amānah*).⁹⁵ Should any loss occur, neither partner is responsible for the *ibḍāʿ* (the *mubḍiʿ* ; neither the owner of the goods) nor the quasi-agent (the *mustabḍiʿ* : the one who receives goods) bears any liability. Such loss is borne by the partnership, as would any other financial loss resulting from transactions personally conducted by either of the partners.⁹⁶

On the other hand, Mālikī law holds that members of a partnership do not possess the right to deposit any portion of the common property with a third party because deposits are not considered to be a part of trade.⁹⁷ If one partner deposits any portion of the common capital (property), he is fully liable to his partners for the loss unless he can prove that there were compelling circumstances for his action.⁹⁸

ii. Loans in *mufāwadah* partnership

Islamic law distinguishes between two types of loans. One, the *qarḍ*⁹⁹ (loan of a fungible object for consumption), involves the loan of fungible commodities, that is goods, which may be estimated and replaced according to weight, measure and number.¹⁰⁰ According to Ibn Hazm (d. 456 A.H.), a *qarḍ* which also implies future

⁹⁵ Shaybānī, *op. cit.*, fol. 62, li. 20ff.

⁹⁶ *Ibid.*

⁹⁷ Sahnūn, Vol. XII, p. 77.

⁹⁸ *Ibid.*, pp. 75 - 76.

⁹⁹ Literally, *aqraḍahu* means, he cuts off for him a portion to be requited or recompensated for it. Legally, it signifies, he granted him a loan (*qarḍ*) or the like. See Lane, Vol. II, p. 2515; *Mughnī*, Vol. IV, p. 313; *M. Muḥtāj*, Vol. II, p. 117; Dusūqī, *Hāshiyah*, Vol. III, p. 222; *Hash A*, Vol. IV, p. 179.

¹⁰⁰ *Mughnī*, Vol. IV, p. 314; *Shirāzī*, Vol. I, p. 303; *M. Muḥtāj*, Vol. II, p. 118; *Hash A*, Vol. IV, pp. 179 - 195.

obligation (*dayn*) is a good deed involving the lending of a fungible object such as money, an animal, houses, lands or others, whether movable or immovable properties, by one to another person on condition that the borrower is responsible for returning the equivalent or the like of that which he has received, either immediately or at a specified time.¹⁰¹ In this case, the borrower takes the same object or the like of what he has borrowed without any premium on the property, which would, of course, be construed as interest.¹⁰² It is also known as *salaf*.¹⁰³

The second type of loan is the *‘āriyah*¹⁰⁴ (loan for use) which transfers the usufruct of property gratis to the borrower. The ownership of the object of the loan remains that of the lender, and the borrower is not liable for any destruction of the loaned property or any diminution of its value except in the case of negligence.¹⁰⁵ The borrower is entitled to make use of the loan without compensation in accordance with the conditions of the contract or of custom.¹⁰⁶ The borrower may lend the borrowed object to a third party, but he must not hire it out or give it as a security and he must meet the maintenance expenses of the property while it is in his

¹⁰¹ *Muḥallā*, Vol. VIII, pp. 77, 79 and 82; Cf. Schacht, *Introduction*, p. 157.

¹⁰² *Transaction*, pp. 199 - 200.

¹⁰³ Ibn al-Athīr, Vol. II, p. 390; *Mughnī*, Vol. IV, p. 313.

¹⁰⁴ Literally, *‘āriyah* means what is taken by persons by turn. Legally, *‘āriyah* is defined as putting one in possession of the use of a thing without anything given in exchange or putting another temporarily and gratuitously, in possession of the use of a thing, the substance of which is not consumed by its use. See *Bidāyah*, Vol. II, pp. 235 - 236; *Umm*, Vol. IV, p. 37; Sab, Vol. III, p. 239; Al-Nawawī, *Rawḍat al-Ṭālibin*, Vol. IV, p. 70; *Muḥallā*, Vol. VIII, p. 168; Lane, Vol. II, p. 2195; Coulson, *Commercial Law*, p. 24; Schacht, *Introduction*, p. 157.

¹⁰⁵ *Muḥallā*, Vol. VIII, p. 168; Sab, Vol. III, p. 239; Schacht, *Introduction*, p. 157; Coulson, *Commercial Law*, p. 24.

¹⁰⁶ *Bidāyah*, Vol. II, pp. 235 - 236.

possession.¹⁰⁷ The owner may, demand the return of the object at any time or at the termination of the loan, according to the contract.¹⁰⁸

Neither partner has the right individually to grant a *qarḍ* loan from the common funds because the bonds of mutual agency and surety between the partners extend only to matters connected with trade. A *qarḍ* loan can be given with the full agreement of both partners.¹⁰⁹

If a partner, individually, grant a loan for use (*ʿāriyah*) to a third party such as a pack of animals belonging to the partnership which collapses under the borrower, then by analogy, he is liable for half the value of the animals to his partner.¹¹⁰ However, a partner can, individually, grant a loan for use from the partnership property (common funds) which is intended to apply primarily to what al-Sarakhsī calls "the accompaniments of trade (*tawābiʿ al-tijārah*) from which the merchant (partner) finds no escape."¹¹¹ A partner can also make use of partnership property for loans and other generous purposes conditioned by practice of the merchants (*min ṣanīʿ al-tujjār*).¹¹²

¹⁰⁷ *Umm*, Vol. IV, p. 37; Schacht, *Introduction*, p. 157.

¹⁰⁸ *Transaction*, p. 199; *Bidāyah*, Vol. II, p. 235.

¹⁰⁹ *Mabsūf*, Vol. XI, p. 180; Kāsānī, Vol. VI, p. 72.

¹¹⁰ However, on the grounds of *istiḥsān* (juristic preference), al-Shaybānī holds that he (a partner) does not become liable if the animal borrowed died while in the possession of the borrower. Al-Shaybānī, "*Kitāb al-Sharikah*", fol. 62b, li. 1 - 3.

¹¹¹ For example, if someone with whom he is doing business approaches him, he has no alternative but to lend him, such as a garment to wear, for he who does not grant loans for use to others, will not receive them when he is in need of them. See *Mabsūf*, Vol. XI, pp. 180 - 181.

¹¹² *Ibid*, p. 193.

By contrast, no liability attaches either to the lender (partner) or borrower if the partnership property is destroyed while in the possession of the borrower, lent out with full agreement of the partners.¹¹³

However, according to Mālik, neither partner is allowed to take or grant a loan for use (*‘āriyyah*) from the partnership funds in connection with the pursuit of the company's business except for some trivial things¹¹⁴ or matters which are intended to benefit the partnership with the permission of his colleague.¹¹⁵ If either partner takes or grants a loan for use (*‘āriyyah*) without his colleague's permission, he alone is responsible for the full extent of any damage that might befall the borrowed object.¹¹⁶

The argument given by Mālik is that, he (a partner) can constitute an injury to his colleague if he borrowed, for example, the pack of animals or the ship whose value is one hundred *dīnārs*, when he could have hired them at a fee of one *dīnār*.¹¹⁷

iii. Purchase, sale and debts of the *mufāwadah* partners

The liability for obligations arising from the commercial activity of the *mufāwadah*'s partners is joint and several. In this regard, any business purchase made by either of the partners such as merchandise, houses or whatever, belongs in equal

¹¹³ Al-Shaybānī, *op. cit.*, fol. 62b, ll. 1 - 3.

¹¹⁴ For example, ordering a servant to water their partnership's animal so as to benefit their trade.

¹¹⁵ Saḥnūn, Vol. XII, p. 79.

¹¹⁶ *Ibid*, pp. 78 - 79.

¹¹⁷ *Ibid*.

shares to each of them. However, this partnership purchase does not apply equally if either partner purchases cloth, food and other household necessities for the consumption and ownership of the partner's families.¹¹⁸ The *mufāwadah* partners are regarded as one individual concerning the rights and obligations arising from any purchase or sale with their joint capital.¹¹⁹ The price of a purchase made by one of them can be collected from the other. Either partner may cancel a sale or purchase made by the other, and either one may return any defective merchandise bought by the other.¹²⁰ Similarly, any defective merchandise sold by any one of them can be returned to either of the partners.¹²¹ Both partners also have the right to sell the *mufāwadah* merchandise on credit even if this right is not explicitly stated in the partnership contract.¹²² Moreover, both of them can buy goods on credit provided the amount involved in these purchase is not in excess of the total amount of the joint capital.¹²³

The rights and obligations arising from any sale or purchase on credit is also binding on both partners.¹²⁴ In this regard, a distinction should be made between the payment and collection of a debt owed by one partner and debt owed to one of

¹¹⁸ Saḥnūn, Vol. XII, p. 71; *Bidāyah*, Vol. II, p. 193; Kāsānī, Vol. 6, p.74; Shaybānī, "*Kitāb al-Sharikat*", fols. 73 - 73b; *Fath Q.*, Vol.VI, p. 191; Wahbah, Vol. IV, p. 823.

¹¹⁹ Saḥnūn, Vol. XII, p. 69.

¹²⁰ Kāsānī, Vol. VI, pp. 70 - 71 and 75.

¹²¹ Saḥnūn, Vol. XII, p. 81.

¹²² *Ibid.*, p. 71.

¹²³ *Ibid.*

¹²⁴ Shaybānī, "*Kitāb al-Sharikāh*", fol. 74, l.2; *Hash. A.*, Vol. III, p. 369.

them.¹²⁵ Money owed by one of them can be collected from either, because a commitment made by one partner is binding on the other. This includes all debts except those arising from criminal liability (*jināyah*) or from marital obligation such as the amount due for a dowry (*mahr*) because they are beyond the bounds of the mutual surety comprehended by the *mufāwadah* partners.¹²⁶

The situation is different in the case of debts owed to one of the partners because not all the debts in this category can be collected by his partner from the debtor.¹²⁷ i. e. the difference would seem to be between debts owed to the partnership (company), and debts owed to the individuals, for example, the proceeds from the sale of property inherited by one of the partners. Consequently this debt is not part of the joint capital and can only be collected by the partner concerned.

Each of the *mufāwadah* partners has the right independently to grant a postponement of the payment of the debt owed to the partnership or to offer a discount on goods whose sale has already been negotiated by the partners. However, if either of the partners, motivated only by business considerations, granted a postponement of the debt or discount of sale of goods in order to cultivate good will and attract customers, his partner can raise a complaint against him, and if this was done as a personal favour, his partner can demand the immediate payment of his share of the debt or the discount.¹²⁸ In this case, the reason given is that a partner is

¹²⁵ *Hash A.*, III, p. 369; *Wahbah*, Vol. IV, p. 822.

¹²⁶ *Mabsūt*, Vol. XI, p. 203; *Hash A.*, Vol. III, p. 369; *Fath Q.*, Vol. VI, p. 101; *Wahbah*, Vol. IV, pp. 823 - 824.

¹²⁷ *Fath Q.*, Vol. III, p. 110.

¹²⁸ *Sahnūn*, Vol. XII, pp. 73 - 74.

not entitled to special consideration in the price of any joint property he wishes to purchase or sell exclusively for himself.¹²⁹

iv. Expenses in *mufāwadah* partnership

All business expenses connected with the pursuit of trade are to be covered from partnership capital. These include living expenses while traveling on business, fees to cover the hiring of help and equipment for the transportation and handling of merchandise, taxes and customs expenses and maintenance of company property. All money expended or debts incurred by one of the partners for such activities can be taken out from the joint capital.¹³⁰

All personal and family's regular expenses incurred by one of the partners can also be taken out from the partnership capital.¹³¹ Personal expenses covered by the partnership account include only food, clothing and any other regular and necessities expenditure bought by either of the *mufāwadah* partners for his own and his family's use.¹³² Concerning the purchase by one partner of cloth, if the garments are of the kind that are not used in daily wear such as fine linen and silk brocade garments, this expenditure cannot be taken out from the partnership capital because they are classified as luxury items.¹³³

¹²⁹ *Ibid.*, p. 75.

¹³⁰ Shaybānī, "*Kitāb al-Sharikah*", fol. 69 b, l.9; fol. 70, l. 13; fol. 73, l.6; fol. 73b, l.3; Ṣaḥnūn, Vol XII, p. 68.

¹³¹ Ṣaḥnūn, Vol. XII, p. 68.

¹³² *Ibid.*, pp. 69 - 70.

¹³³ *Ibid.*, pp. 69 - 70.

v. Investment with third parties

The *mufāwadah* partner may, without the prior consultation of his colleague, invest cash or goods from their common funds in a *muḍārabah* contract or accept capital from outside parties as a *muḍārabah*. Any profits or losses resulting from such enterprise are reckoned to the partnership capital and are shared equally by both parties.¹³⁴

Either *mufāwadah* partner may also, on his own initiative and without the prior consent and knowledge of his colleague, form an *‘inān* partnership with a third party, whether in a single venture partnership (*al-‘inān al-khāṣṣ*) or a more inclusive type of association (*al-‘inān al-‘āmm*). In both cases, his partner is bound to the commitment of one *mufāwadah* partner of the joint capital.¹³⁵

The one type of association which neither partner can contract with a third party unless he has the prior consent and full and express agreement of all his colleagues is a second *mufāwadah* partnership. If either partner does so, the contract is considered as null and void, and is treated as an *‘inān* partnership.¹³⁶

vi. Limit of mutual surety

The mutual surety existing between the *mufāwadah* partners is confined only to

¹³⁴ Al-Shaybānī, *op. cit.*, fol. 70b, II. 14ff; Saḥnūn, Vol. XII, p. 78.

¹³⁵ Al-Shaybānī, *op. cit.*, fol. 70, I. 18.

¹³⁶ *Ibid*, II. 1ff; See also Saḥnūn, Vol. XII, p. 78.

their business-connected activities.¹³⁷ The limit of their mutual surety is not extended to activities which are not directly related to their trade affairs such as their personal expenses¹³⁸ and criminal acts.¹³⁹

The personal expenses include all financial obligation connected with the marriage and family life of the partners such as the payment of the dowry and other mandatory payments which a marriage contract (*‘aqd*) might give rise to, and are borne solely by the partners involved.¹⁴⁰ Similarly, if one of the partners commits a crime, in error or by premeditation, whether it was intentional or unintentional or whether or not it took place in the course of some commercial activities, no liability attaches to his partner. Any indemnity for which one of the partners may be liable as a result of any criminal action (*jināyah*) is borne solely by him, and not by his partner.¹⁴¹

The following topics will discuss the principles of *wakālah* and *kafālah* which are related to the limit of mutual surety in a *mufāwadah* partnership because each of the *mufāwadah* partners is both an agent (*wakīl*) and guarantor (*kafil*) for his colleague.

a. Concept of *wakālah* (agency; procurement)

In the course of doing business, a merchant may appoint another party to perform

¹³⁷ Kāsānī, Vol. VI, p. 73.

¹³⁸ Shaybānī, *op. cit.*, fol. 71b, II. 4 - 6; Saḥnūn, Vol. XII, p. 84.

¹³⁹ Saḥnūn, Vol. XII, p. 84.

¹⁴⁰ Saḥnūn, Vol. XII, p. 84; Kāsānī, Vol. VI, p. 73.

¹⁴¹ *Al-Shaybānī*, fol. 70, II. 13 - 17; Saḥnūn, Vol. XII, p. 84.

certain tasks such as sale and purchase of commodity on his behalf. In the *fiqh* literatures, *wakālah* is explained as a legal relationship in which an agent (*wakīl*) is authorised by the principal (*muwakkil*) to execute a permissible and determined right of disposition (*taṣarruf ja'iz ma'lūm*)¹⁴² or to perform some service for him.¹⁴³ Al-Shāfi'ī elaborates this in the following way : "Agency is a contract when a person delegates (the function) he is supposed to execute, to an agent in matters where delegation is allowed (*min ma yaqbal al-niyābah*) due to be performed during his lifetime".¹⁴⁴

Ibn 'Arfaḥ said that agency arises when one party authorizes another to replace him in the exercise of civil dealings. In that sense, an agent may be entrusted with all acts which can be done by a representative, such as concluding a contract, collecting a sum due, assigning a debt or discharging a debtor and others.¹⁴⁵

According to jurists¹⁴⁶ the legality of the contract of *wakalah* is found in the verses of the Qur'an which read: "Send one of your number with this money of yours to the city",¹⁴⁷ and "then send an arbitrator (*negotiator*) from your family and an

¹⁴² Kāsānī, Vol. VI, p. 19; *Hash. A.*, Vol. IV, p. 471; *Hidāyah*, Vol. III, p.136; *Mabsūf*, Vol. XIX, p. 2; *M. Muḥtāj*, Vol. II, p. 217; *Bidayah*, Vol. II, p. 226; *Mukhtaṣar*, p.201; *Minhāj* N, p.135; Al-Nawawī, *Rawḍāt*, Vol. III, p. 522; Shirāzī, Vol. I, p. 487; Schacht, *Introduction*, p. 120.

¹⁴³ Otto Spies, " *Wakāla*", in *El(I)*, Vol. IV, 1934, p. 1094.

¹⁴⁴ *M. Muḥtāj*, Vol, II, p. 217; Shirāzī, Vol. I, pp. 486 - 487; Al-Nawawī, *Rawḍāt*, Vol. III, p. 522.

¹⁴⁵ *Mukhtaṣar*, p. 201; *Cf. Maj. 'Adliyyah*, art. 1449.

¹⁴⁶ *Mabsūf*, XIX, p. 2.

¹⁴⁷ Q, 18 : 18.

arbitrator from his family".¹⁴⁸ According to jurists, these verses are the authorisation for the contract of *wakālah*.¹⁴⁹

The legalization of the practice of *wakālah* can also be found in several traditions, for example, the Prophet authorised Ḥakīm b. Ḥazm to purchase a sacrificial lamb,¹⁵⁰ and on another occasion the Prophet appointed ʿAmr b. Umayyah al-Ḍamrī as his wakīl at his marriage with Umm Ḥabībah,¹⁵¹ From the above evidence, it can be said that the representation through the contract of *wakālah* has legal effects between the principal, the agent and the third party.

It has also been noted by the jurists that one of the major reasons for the acceptance of the contract of *wakālah* is an urgent necessity for man, since man is sometimes not in a position to administer his own property when on a journey or on the pilgrimage, or to manage his estate on account of his lack of ability or his great wealth.¹⁵² By *wakālah* he can appoint his agent to perform the above tasks on his behalf.

Concerning the commercial practices that can be delegated, it is established that any person may appoint any other person as his agent to perform any act which he

¹⁴⁸ Q, 4:39.

¹⁴⁹ See for example *Mabsūf*, Vol. XIX, p. 2; *M. Muḥtāj*, Vol. II, p. 217; *Mughni*, Vol. V, p. 87.

¹⁵⁰ Abū Dāwūd, *Sunan*, Vol. III, pp. 384 & 427; Ibn Mājah, *Sunan*, Vol. II, p. 73; *Mabsūf*, Vol. XIX, p. 2; *Awfār*, Vol. V, p. 270.

¹⁵¹ *Awfār*, Vol. V, p. 269.

¹⁵² *Mabsūf*, Vol. XIX, p. 2; *Hidayah*, Vol. III, p. 136; *M. Muḥtāj*, Vol. II, p. 217; *Shirāzi*, Vol. I, p. 248; *Fath Q*, Vol. VII, p. 500; *Mughni*, Vol. V, p. 87.

can himself perform. For example, a principal can appoint an agent for buying and selling, giving and taking hire (*ijārah*), giving or taking a pledge (*rahn*), giving and taking a deposit (*wadī'ah*), receiving payment of debt and others.¹⁵³ What is important is that the subject-matter of the agency must be known.¹⁵⁴

As in other transactions, the usual formalities of *ijāb* and *qabūl* should have to be observed by the parties in order to establish a legal relationship between them.¹⁵⁵ That process will allow the principal to inform the agent that he has appointed him as agent (*wakīl*) for a certain purpose by using any expression indicating that intention.¹⁵⁶ An offer can be treated as valid only if it is in the form of permission and ratification.¹⁵⁷

As regards conditions of agency, it is required that the principal and agent must be of sound mind and understanding, and both persons must be able to dispose of their property (*iṭlāq al-taṣarruf*) and in such a degree the agent may be able to know and execute the business to which he has been appointed.¹⁵⁸ In this regard, a minor

¹⁵³ *Mughnī*, Vol. V, p. 89.

¹⁵⁴ *Maj. 'Adliyyah*, arts. 1458-1459; al-Nawawī, *Rawḍat*, Vol. III, pp. 527 - 528.

¹⁵⁵ The principal must make use of words that leave no doubt as to his consent. Thus, for example, he should say, "I appoint you my agent for such and such a business", or "I intrust it to you", or "You will be my agent". It is opined that for the validity of an appointment as agent the law does not require an express acceptance (*qabūl*) on the part of the agent. However, some jurists maintain the contrary opinion. See Minhāj N, p. 135; see also al-Suyūṭī, *al-Ashbāh wa al-Nazā'ir*, p. 224; al-Ramli, *Nihāyah al-Muḥtāj*, Vol. V, p. 27.

¹⁵⁶ See refs. no. 154; *Fath Q.*, Vol. VII, p. 511, Vol. VIII, p. 4.

¹⁵⁷ The extreme case is the *fudūlī*, wherein subsequent ratification of a sale is accepted as having the same effect as a previous authorization to act as agent. *Maj. 'Adliyyah*, arts. 1451-1454.

¹⁵⁸ *Hidāyah*, Vol. III, p. 137; *M. Muḥtāj*, Vol. II, pp. 317-318; see also 'Alī al-Khafīf, *Aḥkām al-Mu'āmalāt al-Shar'iyyah*, p. 276.

(*ṣabī*), a lunatic (*majnūn*), a slave (*ʿabd*) or any one who is *mahjūr* cannot be either principal or agent.¹⁵⁹

The agent is considered as a trustee (*amin*) as regards the delegated undertakings when a *wakālah* contract is concluded. If he acts gratuitously and does not exceed his power, he is not liable for loss or accidental deterioration, except in the case of *taʿaddī* and *tafriṭ*, similar to that of *wadīʿah*. On that basis his testimony is admissible.¹⁶⁰

Another aspect which is worth noting is that the appointment of an agent may be unspecific (*tafwīḍ ʿāmm*; general) or a specific delegation (*tafwīḍ khāṣṣ*) as that will be an important characteristic for the determination of liability. The agent of unspecific delegation is contracted by using the words, "Act at your discretion".¹⁶¹ In this case, the agent's act includes what is susceptible for delegation (*niyābah*) in financial matters (*al-umūr al-māliyyah*)¹⁶² and even others if it has been so agreed, except in the case of the principal's divorce and the sale of his house.¹⁶³ Normally, however, it is of a specific delegation where his task is to do a particular thing¹⁶⁴ and its contents must be clearly defined.¹⁶⁵ In this case, the agent powers are limited by

¹⁵⁹ *Hidāyah*, Vol. III, p. 137; *Fath Q.*, Vol. VII, pp. 512 - 515; Otto Spies, *op. cit.*, p. 1094.

¹⁶⁰ *Minhāj N*, p. 136; Sābiq, *Fiqh al-Sunnah*, Vol. III, p. 299.

¹⁶¹ Schacht, *Introduction*, p. 120.

¹⁶² Sābiq, *Fiqh al-Sunnah*, Vol. III, p. 299.

¹⁶³ *Mukhtaṣar*, p. 201.

¹⁶⁴ *Ibid.*, pp. 201-202.

¹⁶⁵ Al-Ramli, *Nihāyah*, Vol. V, p.47; Schacht, *Introduction*, p. 120.

his principal's instruction and he is bound not to exceed them in any way.¹⁶⁶

Wakālah in sale

If contract of *wakālah* in sale (*bayʿ*) is concluded without any clear instruction in respect of price or mode of payment, the agent is not allowed to sell the merchandise except at a standard market price (*thaman al-mithl*) and by cash. If the agent sold the merchandise by instalment (*mu'ajjalan*), the sale would not be allowed unless the principal endorsed it.¹⁶⁷ This is decided so because the agent's action is likely to infringe the principal's interest and thereby his approval needs to be sought.

If the agent is appointed based on unspecific delegation (*wakālah muṭlaqah*), it does not amount to allowing the agent total freedom in his action but rather expects that the agent will discharge his tasks guided by the accepted customary commercial practices and what is beneficial and favourable to the principal.¹⁶⁸ This view is the preferred one even though there are dissenting views which hold that the action of the agent should be treated as totally unspecific and thus can be executed accordingly.¹⁶⁹

On the contrary, in the case of specific delegation in which the terms and

¹⁶⁶ *Mukhtaṣar*, pp. 201-202.

¹⁶⁷ *Ibid.*; *Fatḥ Q.*, Vol. VIII, pp. 27 - 28.

¹⁶⁸ *Mukhtaṣar*, pp. 201 - 202; *Fatḥ Q.*, Vol. VIII, p. 29.

¹⁶⁹ *Hidāyah*, Vol. III, p. 145 ; al-Shāfiʿī rules that if the variation goes against the principal, the agent's transaction is void. However, Hanafīs treat such a case as *bayʿ al-fuḍūlī* (sale of uncommissioned agent) wherein the validity of the transaction is suspended (*tawaqquf*) subject to the ratification of the principal. If the principal ratifies, the sale is valid, otherwise the transaction is invalid. See *Mabsūṭ*, Vol. XIX, p. 45.

conditions of the contract are well-defined (*wakālah muqayyadah*), the agent is bound by the instruction set by the principal. In other words, the agent is not allowed to sell the merchandise against the instruction given unless it would be advantageous to the principal. For example if the agent is instructed to sell merchandise at a certain price but sells it at a higher price, the transaction is valid. However, if the merchandise is sold at a lower price than the *thaman al-mithl* or the price set for him, the transaction is considered valid but he is liable for *damān al-naqs* (compensation for reduction).¹⁷⁰

Wakālah in purchase

In *wakalah* in purchase (*wakālah fī al-shirāʿ*), the principal is required to state the nature of the commodity to be purchased and the price of it, in order that the agent may know the nature of the act for which he has been appointed and then become capable of executing it. If he is appointed as an absolute (*muflaqah*) agent by saying to him, "Purchase for me whatever thing you may judge advisable", in this case, the explanation of the nature of the commodity is unnecessary.¹⁷¹

As in the case of *bayʿ*, the agent is bound by the principal's instructions. If he acts in contravention of that instruction as to the nature of the merchandise purchased, he is bound thereby,¹⁷² however, more advantageous the thing may be. The merchandise is considered to have been bought by the agent for himself, not for

¹⁷⁰ *Ḍamān al-naqs* is said to be the difference between sale in ordinary situation and the situation where *ghubn* (*laesio*) has taken place. See Ibn Qudāmah al-Maqdisī, *al-Sharḥ al-Kabir*, Vol. V, p. 78.

¹⁷¹ *Hidāyah*, Vol. III, p. 139; Cf. *Mabsūṭ*, Vol. XIX, pp. 38 - 40.

¹⁷² For example, if the agent purchases merchandise with redhibitory defects (*actio redhibitoria*), he is responsible for it. See *Minhāj N*, p. 135; *Hidāyah*, III, p. 139; *M. Muḥtāj*, Vol. II, p.225; *Fath Q.*, Vol. VIII, p. 34.

the principal.¹⁷³

If a dispute arises between the principal and his agent as to the essential nature of an appointment, for example, if the agent maintains that the principal instructed him to sell merchandise on credit or to buy it for certain price, while the former contends that it was to be sold for cash or bought for certain other price, the presumption is in favour of the principal if he takes the oath.¹⁷⁴ Further, if the dispute arises between them regarding the purchase of a specific merchandise, the declaration of the agent must be credited.¹⁷⁵

b. Concept of *kafālah* (suretyship)

In the classical works of Islamic law, *kafālah* is treated as a gratuitous contract (*‘aqd al-tabarru‘*). It is also known as unilateral contract, a disposition that may be completed by unilateral will (*irādah munfaridah*), and not dependent on the acts of both parties as in a bilateral transaction (*‘aqd al-mu‘āwadah*). It is considered as a good deed and subservience to God (*jā‘ah*) that will be rewarded, simply because the guarantor or surety (*kafil*) is willing to act as such, without any pecuniary return or in legal terms known as without any consideration.

Generally, the legal manuals have adopted this notion of *kafālah* as being gratuitous. However, the change of time and circumstances has brought about a

¹⁷³ *Maj. ‘Adliyyah*, art. 1471 reads, "If the principal instructs the agent to purchase a ram and he buys a sheep, the principal is not bound thereby, and the sheep belongs to the agent."

¹⁷⁴ *Minhāj* N, p.138.

¹⁷⁵ *Hidāyah*, Vol. III, pp. 142 - 143.

change of attitude towards *kafālah*, from being accepted as just a gratuitous contract to being considered as a burden and liability whereby the guarantor has undertaken to answer for the debt, default or miscarriage of another person. In this regards, the guarantor is taking responsibility for the due performance of the obligation of another person (whether imposed by the law or contract) in the event of that person failing to perform that obligation as required.

Literally, *kafālah* means responsibility, amenability or suretyship,¹⁷⁶ and technically, it is the pledge given by the guarantor or the surety (*kafil*) to a creditor (*makfūl lah; dā'in*) on the behalf of the principal debtor (*ʿasil; makfūl ʿanh*), to secure that the guaranteed (*makfūl bih*), i.e. the debtor will be present at a definite place, e.g. to pay his debt or fine or in the case of retaliation, to undergo punishment.¹⁷⁷

The legality of *kafālah* is recognised by the Qur'ān and the Prophet. A verse of the Qur'ān says: "(Jacob) said: never will I send him with you until ye swear a solemn oath to me, in God's name, that ye will be secure to bring him back to me".¹⁷⁸ According to al-Qurṭubī, this verse is the basis for the legality of *kafālah* for a person (*kafālah bi al-naḥs*).¹⁷⁹ It is also known as *ḥamālah* involving the corpus of a property or capital asset (*ʿayn*) and the security or suretyship (*wathīqah*).¹⁸⁰

¹⁷⁶ Lane, Vol. II, p. 3001.

¹⁷⁷ *Mabsūf*, Vol. XIX, p. 161; Th.W. Juynboll, "Kafālah", *EI(I)*, Vol. II, (1913 - 1936), p. 618; Sābiq, *Fiqh al-Sunnah*, Vol. III, pp. 333-334. According to Schacht, however, suretyship in Islamic Law is the creation of an additional liability with regard to the claim, not to the debt, the assumption not of the debt but only a liability, and it has its origin in procedure, see Schacht, *Introduction*, p. 158.

¹⁷⁸ Q.12:66.

¹⁷⁹ al-Qurṭubī, *al-Jāmiʿ li Ahkām al-Qur'ān*, Vol. IX, p. 225.

¹⁸⁰ *Ibid*.



According to al-Kāsānī, *hamīl* means the one or person who is responsible for suretyship and may also connote *kafil*.¹⁸¹ Another verse says "For him who produces it, is (the reward of) a camel-load; I will be bound by it".¹⁸² According to al-Ṭabarī the word *za'im* in this verse implies *kafil*.¹⁸³

In the Traditions, the Prophet is reported to have said, concerning *kafālah*: "The surety (*za'im*) is a guarantor (*gharīm*)".¹⁸⁴ To support the justification or legality of *kafālah*, al-Shafi'ī reported a tradition which recounted how, when Qubaysah ibn al-Mukhāriq had a suretyship, the Prophet told him: "O Qubaysah (Ibn al-Mukhāriq)! requesting (things) is forbidden except in the three things, first, when a man has a suretyship then request for it is permissible.....".¹⁸⁵ According to al-Muzanī (d. 264 A.H.),¹⁸⁶ in the above first tradition, *za'im* implies *kafil* (the surety; guarantor),¹⁸⁷ and according to al-Kāsānī¹⁸⁸ *gharīm* has the connotation of *dāmin* (a guarantor) in this instance.¹⁸⁹

¹⁸¹ Kāsānī, Vol. VI, pp. 2-3; Cf. *Lisān*, Vol. XI, p. 180.

¹⁸² Q. 12 : 72.

¹⁸³ Al-Ṭabarī, *Jāmi' al-Bayān*, Vol. XII, p. 20.

¹⁸⁴ Abū Hanīfah, *Jāmi' Masānid al-Imām al-Ā'zam*, Vol. II, compiled by Muḥammad ibn Maḥmud al-Khawarizmi (d. 665 A.H.), Hyderabad, 1953, pp. 58 and 73 (cited hereafter as Abū Hanīfah, *Masānid*); al-Shaybānī, *Amālī*, p. 33; Dāwūd, III, p. 402; Tirmidhi, *Saḥīḥ al-Tirmidhi*, V, p. 269; Ibn Mājah, *Sunan*, II, p. 74; *Fath Q.*, Vol. VII, p. 165.

¹⁸⁵ *Umm*, Vol. III, p. 234; Cf. Muzanī, Vol. VIII, p. 206.

¹⁸⁶ *Ibid.*

¹⁸⁷ Lane, Vol. I, p. 1233.

¹⁸⁸ Kāsānī, Vol. VI, p. 2; Cf. *Lisān*, Vol. XI, p. 180.

¹⁸⁹ Ibn al-Athīr, Vol. III, p. 363; cf. *Lisān*, Vol. XII, p. 436.

Scope of personal guarantee (*kafālah*)

Generally, the subject of *kafālah* is divided into two categories in Islamic Law. Firstly, *al-kafālah bi al-nafs* (suretyship for the person) which is also known as *ḍamān al-wajh*.¹⁹⁰ This type of *kafālah* is associated with the obligation to secure the appearance of the guaranteed person (debtor) or his agent in a court proceeding or in an extra-judicial arbitration at the stipulated time at the request of the creditor.¹⁹¹

The guarantor, in this case, shall be released if he delivers the person guaranteed to the creditor in a place where settlement or if it is adjudication, as the case may be, can take place. If it is stipulated that the guarantor must deliver the guaranteed person in the court of law, the guarantor must do so and he is not allowed to deliver the guaranteed person to any other place. This type of *kafālah* is annulled by the death of the guarantor or the guaranteed person. However, it will not be the case upon the death of the creditor (beneficiary), where heirs shall have the right to require the guarantor to deliver up the guaranteed person at a specified time.¹⁹²

Secondly, *al-kafālah bi al-māl* (surety for the claim) means that the surety (guarantor) stands as a pledge to the creditor (*makfūl lahu*) that the obligation of the principal debtor will be fulfilled. In this case, it is required that the secured obligation

¹⁹⁰ *Mabsūṭ*, Vol. XIX, pp. 176 - 177 and 179; *Hidāyah*, Vol. III, p. 87; al-Nawawī, *Rawḍat*, Vol. III, p. 486; Jazīrī, Vol. III, p. 224; Sābiq, *Fiqh al-Sunnah*, Vol. III, p. 337.

¹⁹¹ Al-Nasafī, *Istīlāḥāt al-Ḥanafīyyah*, cited in Chafik Chehata, *Theorie generale de L'obligation en droit Musulman Hanefite*, Paris, 1969, pp. 231. See also *Mabsūṭ*, Vol. XIX, p. 177; al-Nawawī, *Rawḍat*, Vol. III, p. 486; Schacht, *Introduction*, p. 158.

¹⁹² Schacht, *Introduction*, pp. 158-159; *Maj. 'Adliyyah*, art. 642; Muḥammad Fawzī Fayḍ Allāh, *Naẓariyyat al-Ḍamān fī al-Fiqh al-Islāmī*, Kuwait, 1983, p. 37.

must be a liability of the principal debtor (*maḍmūn ʿalā al-aṣīl*) and the obligation of the surety (*kafīl*) is dependent (*tābiʿ*) on the liability of the principal debtor.¹⁹³ Suretyship for the claim can be independent or additional to suretyship for the person; if the guarantor stipulates that the debt of the principal debtor be remitted, its effect is that of *ḥawālah*.¹⁹⁴

Legal consequences of a *kafālah* contract

A *kafālah* contract which is concluded by a person of full capacity (*ahliyyah kāmīlah*)¹⁹⁵ and executed by an offer (*ijāb*) from the guarantor and acceptance (*qabūl*) from the guaranteed person¹⁹⁶ will bring about legal values (*aḥkām*), for example, establishing the right to demand from the guarantor (*kafīl*) what is liable on the

¹⁹³ *Maj. ʿAdliyyah*, art. 613; Schacht, *Introduction*, p. 158.

¹⁹⁴ *Ḥawālah* is a way of extinguishing an obligation by transforming it into a new one. Literally it means transfer, see *Lisān*, Vol. XI, p. 190; *Lane*, Vol. I, p. 677; Legally, *ḥawālah* is an agreement by which a debtor is freed from a debt by another becoming responsible for it or transfer of a claim of a debt by shifting the responsibility from one to another, see *Mughni*, Vol. IV, p. 83; *Fath Q.*, Vol. V, p. 443; *M. Muḥtāj*, Vol. II, p. 193; *Hash A.*, Vol. IV, p. 300; Al-Buhūti, *Kashshāf al-Qināʾ*, Vol. III, p. 370; *Mabsūṭ*, Vol. XIII, p. 28; *Muḥallā*, Vol. VIII, p. 108. In its modern usage, it is suggested that the availability of the institution of *ḥawālah* has extended a great deal of facilities to cope with the burden of commercial transactions and provide new ways of satisfaction of debt and giving security which corresponds to the currently used negotiable instruments such as bill of exchange and letter of credit.

¹⁹⁵ *Mughni*, Vol. V, p. 78.

¹⁹⁶ Abū Hanīfah and one of his disciples, Muḥammad al-Shaybānī held that the basic constituents of *kafālah* are offer and acceptance. See *Hash A.*, Vol. IV, p. 261; However, Abū Yūsuf, supported by other schools of law, opined otherwise, saying that mere offer will render a *kafālah* contract valid. See *M. Muḥtāj*, Vol. II, p. 198; *Mughni*, Vol. V, p. 72. A *kafālah* contract is valid and effective if pronounced by a special expression (*sighah muʿayyanah*), and the wordings to be employed, according to Hanafīs and Shāfiʿīs, can either be expressed (*sarih*) or implied (*kināyah*). This simply denotes any utterance that signifies an obligation in the custom and usage of a society. See Kāsānī, Vol. VI, pp. 2-3; *Fath Q.*, Vol. V, p. 292.

principal debtor (*aṣīl*).¹⁹⁷ What is demanded at this stage will depend on the type of *kafālah* concluded by the parties. If the *kafālah* concluded involves *kafālah bi al-māl*, the guarantor can be required to satisfy the entire debt if he is the only surety. If there are two sureties, both of them will share the burden equally provided that there are no specific terms on the matter, as both of them are on the same standing as far as the *kafālah* is concerned. The creditor will have to take into consideration the division of obligation (*al-inqisām*) by which he has to apportion his right of claim (*ḥaqq al-muṭālabah*).¹⁹⁸

On the other hand, if the contract involves *kafālah bi al-nafs*, the guarantor is duty bound to ensure the attendance of the guaranteed person, if that can be done. If he is not available, the guarantor can ask for some time until his attendance can be assured. If he has not produced the guaranteed person during the stipulated time and there is no evidence of his inability to do so, the *qāḍī* can have him arrested until the satisfactory evidences of his failure based on circumstances, testimonies and others can be produced. He will only be released and allowed deferment only after he is in the position to produce the guaranteed person.¹⁹⁹

The majority of jurists²⁰⁰ say that a *kafālah* contract will give the favoured party a right (*ḥaqq*) to claim from the guarantor what he is entitled to. This right,

¹⁹⁷ *Maj. 'Adliyyah*, art. 634 says " The effect of a contract of guarantee is a claim. This is to say, it consists of the right of the person in whose favour the guarantee is made to claim the subject matter of the guarantee from the guarantor".

¹⁹⁸ Kāsānī, Vol. VI, p. 10; *Mabsūṭ*, Vol. XIX, p. 162.

¹⁹⁹ Kāsānī, Vol. VI, p. 10.

²⁰⁰ Among others are Sufyān al-Thawrī, Awzā'ī, Abū 'Ubayd and the three imams Abū Hanīfah, al-Shāfi'ī and Ahmad b. Hanbal. See *Muḥallā*, Vol. VIII, p. 526.

nevertheless, will not relinquish the right of the creditor to claim from the debtor. He can claim from anyone he wishes, or both provided that the claim is within the extent of his entitlement.²⁰¹

In the case of the liability (*dhimmah*) for paying the debt, which has been debated among the jurists, whether or not the principal debtor (*aṣīl*) will be released from the obligation, the Hanafīs rule that the liability will be on the guaranteed person, but the creditor can make his claim from either person.²⁰² Al-Shāfi'ī is of the opinion that a *kafālah* with a condition for release of the principal debtor from liability is not permitted because it is a condition which contradicts the exigency (*muqtaḍā*) of *ḍamān*.²⁰³ Mālik is of opinion that the debtor cannot claim from the *kafīl* except when claiming from the guaranteed person has become impossible. He stresses that *kafālah* is a security (*wathīqah*), and the satisfaction of the obligation will not be demanded from the guarantor except when the principal debtor has failed to do so.

It seems that the the above opinions are of the same philosophy with some variation in the details. The views expressed are that *kafālah* will not give rise to *barā'ah* (release) of the guaranteed person. *Kafālah* is the fusion of the *dhimmah* of a person to another in the sense of *muṭālabah*, and *barā'ah* is contrary to it. If *kafālah* is for the purpose of releasing one's liability, for example debt, it is then

²⁰¹ Al-Dardīr, *al-Sharḥ al-Ṣaghīr*, Vol. II, p. 105.

²⁰² "The person claiming under the guarantee has the option to claim either against the guarantor or against the principal debtor. The exercise of his right against the one in no way destroys his right of claiming from the other. He may claim, first, from the one and then from the other, or from both simultaneously", *Maj. Adliyyah*, art. 644.

²⁰³ Shirāzī, Vol. I, p. 415; *M. Muḥtāj*, Vol. II, p. 207.

hawālah.

Hawālah is the transference of a debt from one person to another. *Hawālah*, literally, means transfer²⁰⁴ or turn.²⁰⁵ Legally, *Hawālah* is an agreement by which a debtor is freed from a debt by another becoming responsible for it or transfer of a claim of a debt by shifting the responsibility from one to another.²⁰⁶

The legal evidence for the *hawālah* is the hadith of the Prophet pertaining to the obligation to repay one's debt; "Procrastination in paying debt by a wealthy man is injustice. So, if your debt is transferred from your debtor to a trustworthy rich debtor (*malī'*), you should agree".²⁰⁷ This tradition indicates that the order of the Prophet to accept *hawālah* by a rich debtor is a recommendation, as was held by the majority of jurists. This contract is considered as a worldly beneficial matter and therefore considered as performance of a good deed (*ihsān*) to the debtor. By doing this, he will release the debtor from his legal obligation for the debt.²⁰⁸ No matter how diverse *kafālah* and *hawālah* may be, there are many points of similarity between

²⁰⁴ *Lisān*, Vol. XI, p. 190; Lane, Vol. I, p. 677.

²⁰⁵ Ch. Huart, "*Hawāla*" in *EI*(2), Vol. III, 1971, p. 292.

²⁰⁶ *Mughni*, Vol. IV, p. 528; *M. Muhtāj*, Vol. II, p. 193; *Qinā'*, Vol. III, p. 370; *Hash. A.*, Vol. IV, p.300; *Fath Q.*, Vol. V, p. 443; *Muḥallā*, Vol. VIII, p. 108; "The *Ḥanafīs* ruled that *hawālah* is tranfer of right of claim (*muṭālabah*) from the *dhimmah* of the debtor (*madīn*) to the *dhimmah* of an assignee (*multazim*). In this respect, it differs from *kafālah* as it involves fusion (*ḍamn*) of liability in the process of claim (*muṭālabah*) and not in transfer. In the *hawālah* deal, the debtor (*madīn*) will not be demanded after the contract is concluded. It is said in manuals of this school that *hawālah* is shifting (*taḥwīl*) of a debt from the liability of principal debtor to that of a delegated payer (*muḥāl 'alayh*) as a means of security (*tawaththūq*). *Hawālah* is a contract permissible in all debts (*duyūn*) but not in goods (*ʿyān*). It is founded on constructive transfer (*naql ḥukm*) not physical". See *Mughni*, Vol. IV, p. 83.

²⁰⁷ *Muw Y.*, p. 562; *Bukhārī*, Vol. VIII, p. 270; *Dāwūd*, Vol. III, p. 337 (no. 3345); *Ibn Mājah*, *Sunan*, Vol. II, pp. 73 - 74; *al-Nasā'i*, *Sunan*, Vol. VII, p. 317; see also *Umm*, III, p. 233; *Muṣannaḥ*, Vol. VIII, pp. 316 - 317.

²⁰⁸ *Al-Sulamī*, 'Izz al-Dīn 'Abd al-Salām, *Qawā'id al-Aḥkām fī Maṣālih al-Anām*, Cairo, 1934, p. 160.

them and they can become complementary to each other insofar as settlement of loans is concerned. As *kafālah* in its modern usage became extended to new transactions, so did *hawālah*.²⁰⁹ It is suggested that the availability of the institution of *hawālah* has extended a great deal of facilities to cope with the burden of commercial transactions and their diverse practices. It can provide new ways of satisfaction of debt and giving security which correspond to the currently used negotiable instruments.

vii. Dissolution of *mufāwadah* partnership

There are two types of circumstances which affect the termination of a contractual partnership. The first is the death,²¹⁰ or the apostasy²¹¹ or the loss of mental competence by one of the partners.²¹² These circumstances cause immediate termination of a partnership regardless of whether or not the surviving partner is aware of the circumstances.²¹³

The second circumstance is the unilateral abrogation (*naskh*) by one of the

²⁰⁹ Muḥammad Aḥmad Sarrāj in his book, *al-Awrāq al-Tijāriyyah fī al-Sharī'ah al-Islāmiyyah*, Cairo, 1988, p. 82, writes : "The law has ordered giving security for debts (*tawthīq al-duyūn*) for a variety of purposes like protection of rights, avoiding disputes (*nizā'*), guarantee (*damān*) for payment of the debt and the creditor's right of priority over the estate of the debtor with others possessing such a right. The method of security rests in, among others, the documentation (*kitābah*) of the loan, certification of a notary (*shahādah*), pledge (*rahn*), transfer of obligation (*hawālah*) and guarantee (*kafālah*)".

²¹⁰ Kāsānī, vol. VI, p. 78.

²¹¹ *Ibid.*

²¹² *Ibid.*

²¹³ *Ibid.*

partners²¹⁴ and the lapsing of equality in eligible capital of one of them.²¹⁵ In these cases, however, the dissolution of the partnership does not become effective until the other partner becomes aware of it.²¹⁶

Mālikī jurists, however, do not mention whether the factors which lead to the termination of a partnership take effect immediately or not. Rather, they merely say that a *mufāwadah* partnership is terminated by the mutual consent of the partners, by the accomplishment of its aim, by the expiration of the term stipulated in the contract or upon the death of one of the partners.²¹⁷

1.3.2. *Sharikat al-‘Inān* (limited investment partnership)

(a) Definition

Sharikat al-‘Inān signifies a limited investment partnership. Literally, *‘Inān* means the rein of a horse, which is held by only one hand of a rider, so that the other hand is free.²¹⁸ Similarly, each of the partners transfers to his colleague the rein of the disposition. It could be derived from the fact that a pack animal has two reins, one of them longer and the other shorter. According to Hanafī law, this type of partnership is permissible both with equal or unequal shares in investment and profit

²¹⁴ *Ibid*, pp. 77 - 78.

²¹⁵ *Ibid*, pp. 78 - 79.

²¹⁶ *Ibid.*, pp. 77 - 79.

²¹⁷ *Saḥnūn*, Vol. XII, p. 84.

²¹⁸ *Mabsūt*, Vol. XI, pp. 151 - 152.

on the part of the partners, and is, therefore, designated *‘inān*.²¹⁹

Legally, an *‘inān* partnership²²⁰ can be described as a contractual or commercial partnership (*sharikat al-‘aqd*) whereby two or more partners contribute to a capital fund, either in money or in kind or in labour or in combining all or some of these investments.²²¹

(b) Legality of *‘inān* partnership.

It is recorded that such partnership was practised in pre-Islamic times.²²² In this regard, W. Heffening suggests that, historically, this partnership was the older form of partnership.²²³

Although the term *‘inān* for this partnership was not used by Mālik, Ibn Rushd, the Mālikī jurist, states that all Muslim jurists are agreed on the validity of the *‘inān* partnership "even if some of them did not use this term and even if they differed

²¹⁹ *Mabsūt*, Vol. XI, pp. 151 - 152; *M. Muhtāj*, Vol. II, p. 212; *Fath Q*, Vol. V, p. 20; *Kāsānī*, Vol. VI, p. 57; *Hash A*, Vol. III, p. 373; *Mughni*, Vol. V, p. 31.

²²⁰ In the *Mudawwanah*, this form of partnership is not designated by any special term and can best be described simply as a non-*mufāwāḍah* partnership, "A Partnership which is not a *mufāwāḍah* partnership, as when two people form a partnership in one commodity or something similar". *Ṣaḥnūn*, Vol. XII, p. 78.

²²¹ *Bidāyah*, Vol. II, pp. 252 - 255; *Mughni*, Vol. V, p. 13; *Jazīrī*, Vol. III, pp. 68 - 79; *Hidāyah*, Vol. III, p. 6; *M. Muhtāj*, Vol. II, pp. 212 - 213; *Kāsānī*, Vol. VI, p. 62; *Mabsūt*, Vol. XI, p. 153.

²²² *Muṣannaf*, Vol. VII, p. 409, Vol. VIII, pp. 258 - 260; *Mabsūt*, Vol. XI, p. 57. Evidence of it appears in a poem by al-Nābighah al-Ja’dī : "And we share with Quraysh in their property, and in their several grounds of pretension to respect with a sharing exclusive of their properties". See *Mabsūt*, Vol. XI, p. 151; *Lane*, Vol. II, p. 154; *Lisān*, Vol. XIII, pp. 292 - 293.

²²³ W. Heffening, *op. cit.*, p. 293.

concerning some of its rules".²²⁴

(c) Classification of *ʿinān* partnership.

ʿInān partnerships are divided (on the basis of its scope) into two general categories: specified (*khāṣṣ*) and general (*ʿāmm*).²²⁵ A general *ʿinān* partnership is formed for the purposes of general business with no restrictions with respect to the commodities that can be dealt with or transactions that can be negotiated.²²⁶ In other words, any legitimate business activity designed to bring profit to the partnership comes within its purview. In this respect, it resembles the *mufāwadah* partnership. The only limitation to which the partners in a general *ʿinān* partnership are subject is the extent of their joint capital.²²⁷

The specified *ʿinān* partnership is formed for the purposes of a specified business transactions. In this partnership, the partners' transactions are confined to a certain category of goods defined in the contract. This arrangement could be a continuing one, enduring over a considerable period of time and involving numerous transactions, or it could be limited to a single venture such as the purchase of specified merchandise and its subsequent resale. The mutual agency (*wakālah*) of the partners in a specified *ʿinān* partnership extends only to those commodities or areas

²²⁴ *Bidāyah*, Vol. II, p. 249.

²²⁵ Al-Kāṣānī opines that it is permissible in its general form, that is, when two people form a partnership for general trade; and it is permissible in its specified form, that is, when two people form a partnership for specific category of merchandise, as, for example, cloth or silk or garments, etc. Kāṣānī, Vol. VI, p. 62.

²²⁶ *Ibid.*

²²⁷ Udovitch, *Partnership*, pp. 123 - 124.

of trade agreed upon.²²⁸ For example, if the contract specified a certain type of goods, each partner is a stranger in relation to any goods purchased by his colleague other than those specified. The purchase or sale for cash or credit by one of the partners is binding on his colleague. If, however, one of the partners buys or sells for cash and credit something outside of the specified goods, it belongs exclusively to him.²²⁹

(d) Conduct of *‘inān* partnership

i. Personal status

An *‘inān* partnership can be formed by any person meeting the minimum standards of legal competence. There are no restrictions with respect to personal status that are peculiar to this contract. Any person who is of age (*bāligh*) and in full possession of his mental faculties (*‘āqil*) may legitimately contract an *‘inān* partnership.²³⁰

The several categories of person excluded because of some limitation in their personal status from participation in a *mufāwadah* partnership are eligible as partners in an *‘inān* partnership. Similarly, a difference in personal status between prospective partners does not constitute a barrier to the formation of a valid *‘inān* partnership.

In this regard, the formation of an *‘inān* partnership between two minors with the explicit approval of their guardian is valid, as is a partnership between a free Muslim

²²⁸ *Mabsūf*, Vol. XI, pp. 173 - 174.

²²⁹ *Mabsūf*, Vol. XI, pp. 173 - 174..

²³⁰ These two characteristics possessed by any person of either sex, are the minimum requirement for legal competence in all transactions. See Wahbah, Vol. IV, p. 122; Udovitch, *Partnership*, p. 125.

and a *dhimmi*.²³¹ Abū Hanīfah, Abū Yūsuf and al-Shaybānī are of the opinion that an *‘inān* partnership between a Muslim and a *dhimmi* is only permissible, if it is the Muslim who oversees the selling and purchasing.²³² In this case, exclusive supervision of the joint venture by a Muslim would remove any possible objection to a Muslim non-Muslim partnership by preventing transactions and business with commodities prohibited to a Muslim.

ii. Form of investment

Capital for an *‘inān* partnership investment can take the form of cash (gold or silver coins).²³³ All Muslim jurists are agreed concerning the acceptability of gold and silver coins for partnership investment.²³⁴ It is also permissible for one partner to invest silver coins (*dirhams*) and the other gold coins (*dinārs*).²³⁵ The legal problems which arise in connection with these denominations are, as in the case of copper coins (*fulūs*). Copper coins do not have the status of currency because on the whole, they can be particularized by specification. Furthermore, the value of their acceptance may differ from time to time, and from place to place. Therefore, if it is accepted as a valid capital in the *‘inān* partnership, this will lead to uncertainty as to the amount of each partner's capital at the time of the division of profits.²³⁶

²³¹ Shaybānī, "*Kitāb al-Sharikah*", fol. 69, II. 2 - 6; fol. 77, II. 19 - 21.

²³² Ibn Qutlūbugha, Qāsim b. Quṭlūbughā (d. 879/1474), *Tāj al-Tarājim fī al-Ṭabaqāt al-Hanafīyyah*, Baghdad, 1962, p. 24.

²³³ *Mabsūṭ*, Vol. XI, pp. 158 - 161 and 178; Kāsānī, Vol. VI, p. 160 - 161; *Fath Q*, Vol. VI, p. 167; Saḥnūn, Vol. XII, pp. 63 - 65; *Bidāyah*, Vol. II, p. 190; *Mughni*, Vol. V, pp. 16 - 18; N. *Minhāj*, p. 132.

²³⁴ *Ibid.*

²³⁵ Al-Qudūri, *Mukhtaṣar*, p. 53; al-Shaybānī, *al-Makhārīj fī al-Hiyal*, pp. 57 - 58.

²³⁶ *Mabsūṭ*, Vol. XI, p. 160.

According to al-Kāsānī, the majority of jurists do not permit the validity of goods as partnership investment because it leads to ignorance regarding the profit at the time of division of profits, since the amount of the investment will consist of the value of the goods and not of the goods themselves, and this value will be unknown except by conjecture and estimate. The amount of profits will, therefore, be unknown and this will lead to dispute among the partners at the time of division.²³⁷

iii. Expenses

Hanafi jurists assert that an *‘inān* partnership is contracted in accordance with the custom of the merchants and in recognition of the necessities of commerce.²³⁸ In this regard, hiring services and equipment for the care and transportation of partnership property is considered to be such a necessity and is an independent right possessed by both *‘inān* partners. Therefore, like a *mufāwadah* partner, an *‘inān* partner could, when necessary, use partnership funds to pay for the transportation of merchandise, with or without the express permission of his colleague. In the case of mishap, the loss is borne by the partnership as a whole.²³⁹

Concerning the travel expenses, each *‘inān* partner is granted the freedom to travel with partnership property for trade purposes, even without the express

²³⁷ Kāsānī, Vol. VI, p. 59.

²³⁸ See for example Kāsānī, Vol. VI, p. 69.

²³⁹ *Ibid.*, pp. 69 - 70

permission of his colleague.²⁴⁰ Since they are allowed the right to travel, they are also allowed to recover all their travel expenses such as fees of leasing, cost of travel, food and sustenance from the joint capital.²⁴¹

iii. Distribution of profit and liability for loss

The distribution of profit in an *‘inān* partnership is in accordance with the agreement between the parties involved²⁴² or in accordance with the proportion of the capital invested,²⁴³ and loss will, therefore, be distributed in proportion to the invested capital and will be borne by the owners of that capital.²⁴⁴

This implies that no supplier of capital can escape his liability for the loss on his proportion of the total capital and that any party who has not invested any capital will not be liable to any loss of capital. In this regard, Abū Hanīfah say:

If two partners in an *‘inān* partnership agree that the profit and loss follow their respective investments, this is permissible. If one of them stipulates for himself a share in the profit proportionally larger than that of his colleague, this is also permissible. If, however, one of them assumes a share of the loss proportionally larger than that of the

²⁴⁰ *Ibid.*, p. 71.

²⁴¹ *Ibid.*, pp. 71 - 72.

²⁴² This is the opinion of Hanafīs, Hanbalīs and Zaydis, see *Mughnī*, Vol. V, p. 27; *Hidāyah*, Vol. III, p. 7; *Mabsūf*, Vol. XI, p. 157; *Fath Q*, Vol. VI, p. 177; *Qinā*, Vol. III, p. 497; al-Shaikh Zayn al-Dīn, Ibn Nujaym, *al-Baḥr al-Rā’iq*, Vol. VI, n. d., p. 188; ‘Alā’ al-Dīn al-Samarqandī, *Tuḥfat al-Fuqahā*, Vol. III, Damascus, 1397/1958, p. 71.

²⁴³ This opinion is held by Shāfi‘īs, Mālikīs, Zāhirīs, Imāmīs and Zufar from the Hanafīs. See *M. Muḥtāj*, Vol. II, p. 216; *Bidāyah*, Vol. II, p. 325; *Shirāzi*, Vol. I, p. 454.

²⁴⁴ *Mabsūf*, Vol. XI, p. 156; *Bidāyah*, Vol. II, p. 303; *Zurqānī*, Vol. III, p. 158; *Jazīrī*, Vol. III, p. 34; *M. Muḥtāj*, Vol. II, p. 309; *Hidāyah*, Vol. III, pp. 202 - 215.

other, this is not permissible.²⁴⁵

The Hanafī principle is based on numerous legal traditions and is epitomized in one attributed to the fourth caliph, ʿAlī b. Abī Ṭālib, " Profit follows the conditions agreed upon and loss follows the capital".²⁴⁶

iv. Differences between *mufāwadah* partnership and ʿ*inān* partnership

It is only its structural features which distinguish the ʿ*inān* partnership from the *mufāwadah* Partnership. Each of the *mufāwadah* partners is both an agent (*wakīl*) and guarantor (*kafīl*) for his colleague.²⁴⁷

Each partner in the ʿ*inān* partnership is only an agent (*wakīl*) and not a guarantor (*kafīl*) of his colleague; and this mutual agency is valid only in the area of commerce covered by their partnership or to the extent of their joint capital. In contrast to a *mufāwadah* partnership, this difference confines the partner's freedom of action with in the conduct of business and severely curtails the rights and claims of third parties toward the partnership.²⁴⁸

²⁴⁵ Al-Shaybānī, *op. cit.*, fol. 61, II. 16 - 18.

²⁴⁶ *Ibid.*; see also M. N. Siddiqi, *Banking Without Interest*, Lahore, 1983, p. 129.

²⁴⁷ *Mabsūṭ*, Vol. XI, p. 174; Kāsānī, Vol. VI, p. 62; Schacht, *Introduction*, p. 156; W. Heffening, *op. cit.*, p. 381.

²⁴⁸ Al-Qudūrī in his works p. 53 stated that : "As for a limited investment partnership (ʿ*inān*), it is contracted on the basis of mutual agency, but not mutual surety. It is valid in the case of a disparity between each partner's investment, and it is valid when they invest equally, but share the profit unequally. It is further permissible for either of the parties to invest only a part of their property, while the rest remains outside the partnership. The form of capital with which it is permissible to contract a limited investment is the same as that which was indicated as permissible in *mufāwadah* the price whatever either of the partners buys for the partnership can be claimed from him alone. He may, then, demand remuneration from the other partner for the latter's share in it. If the entire partnership capital, or the capital

1.3.3. *Sharikat al-ʿamāl* (labour partnership)

Labour or work partnership in artisans usually involves a skill in certain kinds of manufacturing such as tailoring, carpentry, dyeing, weaving and the like.²⁴⁹ The classical works have mentioned this type of venture in several ways such as *sharikat fī al-ʿamal bi aydihimā* (partnership of work with their hands), *al-sharikat bi al-ʿamal* (partnership in work), *sharikat al-abdān* (partnership of bodies), *sharikat al-ṣanāʾiʿ* (partnership of craft)²⁵⁰ and *sharikat al-taqabbul* (partnership of acceptance).²⁵¹

This type of partnership is contracted when two or more professionals, labourers or craftsmen form a work partnership without pooling any cash or goods; their sole asset consists of their particular skills.²⁵² In other words, they become partners and agree to work according to their particular skills and then share their earnings.²⁵³

of one of the partners is lost before everything is bought, the partnership is nullified. However, if one of them purchases something with his own share of the capital and the other partner's share is lost before everything is purchased with it, the purchased merchandise is common property in according with their partnership agreement. The one who laid out the money may demand remuneration from his partner for the latter's share of its cost".

²⁴⁹ *Fatḥ Q.*, Vol. VI, p. 186; Udovitch, *Partnership*, p. 65.

²⁵⁰ *Mabsūṭ*, Vol. XI, p. 152; Kāsānī, Vol. VI, p. 56; *Hidāyah*, Vol. III, p. 10; Abū Yūsūf b. ʿAbd Allāh b. Muḥammad b. ʿAbd al-Barr al-Qurṭubī (d. 1477 AD.), *al-Kāfī fī Fiqh Ahl al-Madīnah al-Mālikī*, Beirut, 1982, p. 392; See also A. L. Udovitch, "Labor Partnership in Early Islamic Law", *JESHO*, Vol. X, 1967, pp. 64 - 80.

²⁵¹ A partnership of acceptance is contracted when two craftsmen form a partnership in the acceptance of work such as tailoring, fulling and the like. It is also designated as the partnership of bodies, because they work with their bodies, and as partnership of craft because their craft is their capital. See *Mabsūṭ*, Vol. XI, p. 152; *Hidāyah*, Vol. III, p. 10; *Fatḥ Q.*, Vol. VI, p. 186.

²⁵² *Ṣaḥnūn*, Vol. XII, p. 43; *al-Kāfī*, p. 392.

²⁵³ Kāsānī, Vol. VI, p. 57; *Mabsūṭ*, Vol. XI, p. 154; *Fatḥ Q.*, Vol. V, p. 28; *Hash A*, Vol. III, p. 380; *Bidāyah*, Vol. II, p. 252; *Mughni*, Vol. V, p. 3.

Al-Sarakhsi holds that this type of partnership is legal because labour can be equated with money as a source of profit.²⁵⁴ He establishes a *qiyās* (analogy) on the basis of *muḍārabah* to justify his opinion that there is a common *‘illah* between the two cases and that claiming profit based on one's work and craft therefore has a cogent legal foundation.²⁵⁵

Historical evidence has also shown that people have been conducting their affairs through this form of partnership without disapproval or criticism or admonition since the time of the Prophet.²⁵⁶ For example, the Prophet approved of two of his followers having a partnership in what they gained in the battle of Badr.²⁵⁷

According to Hanafī and Mālīkī laws, the basis for the permissibility of this type of partnership depends on the same or equal share or reward received by the partners.²⁵⁸

1.3.4. *Sharikat al-Wujūh* (Partnership in Credit)

This type of partnership is based on reputation, where partners do not provide anything but their good reputation. They start their business (partnership) by buying

²⁵⁴ *Mabsūt*, Vol. XI, p. 155; Shāfi‘is, Imāmīs, Zāhirīs and Zufar from the Hanafī school disapprove the validity of this kind of partnership because it depends on labour only. According to the Shāfi‘is, the basic principle of partnership is proprietary (*sharikat al-amwāl*), an element which is not found in this particular partnership. They also argue that intermingling of labour is not realizable. See *M. Muḥtāj*, Vol. II, p. 212; see also *Fatḥ Q*, Vol. V, p. 31.

²⁵⁵ *Mabsūt*, Vol. XI, p. 155.

²⁵⁶ *Ibid.*, pp. 151 - 220; *Mughnī*, Vol. V, p. 3; *Bidāyah*, Vol. II, p. 279; Kāsānī, Vol. VI, p. 59.

²⁵⁷ Abū Dāwūd, *Sunan*, Vol. III, p. 349; Ibn Mājah, *Sunan*, Vol. II, p. 43; *Mughnī*, Vol. V, p. 3.

²⁵⁸ *Mabsūt*, Vol. XI, p. 155; *al-Kāfi*, p. 393.

goods on credit, reselling them and share the profit among themselves (partners).²⁵⁹

The Hanafī and Hanbalī jurists have, in fact, regarded credit as a form of wealth, for like skill in *sharikat al-ʿmāl*, it is used for the production of more wealth.²⁶⁰ According to them, this kind of partnership is valid on condition that each partner receives the same or an equal share of the profit from the business transactions.²⁶¹

Conclusion

The above discussion has mentioned the four forms of commercial partnership in Islamic law, i.e. *sharikat al-mufāwadah*, *sharikat al-ʿnān*, *sharikat al-ʿamal* and *sharikat al-wujūh*. In practice, however, the partners may contribute not only capital in the form of finance, but also labour, management and skills, and credit and goodwill, although not necessarily equally. The *ʿinān* partnership which implies unequal shares seems to be the most popular. In a partnership with mixed contributions (shares) of the partners, the profits accrued would be divided in accordance with a contractually agreed proportion, since Islamic law admits an entitlement to profit arising from a partner's contribution to any one of these three business assets, i. e. capital in the form of finance, labour, management and skills, and credit and goodwill. However, Islamic law makes it absolutely imperative that

²⁵⁹ *Mabsūt*, Vol. XI, p. 154; *Mughnī*, Vol. V, p. 12; *Fath Q*, Vol. V, p. 30; *Kāsānī*, Vol. VI, p. 57; Schacht, *Introduction*, p. 156.

²⁶⁰ *Bidāyah*, Vol. II, p. 212; *Mughnī*, Vol. V, p. 12; *Fath Q*, Vol. V, p. 30; *Mabsūt*, Vol. XI, p. 154; see also Al-Shaʿrānī, *Al-Mizān al-Kubrā*, Vol. I, p. 83.

²⁶¹ *Mughnī*, Vol. V, p. 12; *Mabsūt*, Vol. XI, p. 154; *Kāsānī*, Vol. VI, p. 57; Schacht, *Introduction*, p. 156; *Fath Q*, Vol. V, p. 30.

losses be shared in proportion to the contribution made to capital. This is because losses constitute an erosion in capital and must be charged to it.

CHAPTER TWO

***MUḌĀRABAH* (DORMANT PARTNERSHIP)**

AS A MODE OF FINANCING

CHAPTER TWO : *MUḌĀRABAH* (DORMANT PARTNERSHIP) AS A MODE OF FINANCING

2.1. Definition

Muḍārabah or dormant partnership is synonymous with two other Arabic terms which are used to designate this kind of business organization, *qirāḍ* and *muqāraḍah*. These three terms are interchangeable with no essential difference in meaning or connotation among them.¹ The divergence in terminology was probably originally due to geographical factors. The terms *qirāḍ* and *muqāraḍah* apparently originated in the Arabian Peninsula, especially the *Hijāz*,² and the term *muḍārabah* was of 'Iraqī provenance.³ Subsequently, the difference was perpetuated by the legal schools, with the Mālikīs⁴ and Shāfi'īs⁵ adopting the term *qirāḍ* and, to a lesser degree *muqāraḍah*, and the Hanafīs⁶ and Hanbalis⁷ adopting the term *muḍārabah*.

According to the Hanafī jurist al-Sarakhsī, the term *muḍārabah* is derived from the expression "making a journey" (*al-ḍarb fī al-arḍ*). This term is used because the agent-manager (*muḍārib*) is entitled to the profit by virtue of his effort and work.

¹ *Lisān*, Vol. VII, pp. 217 - 218; *Tāj*, Vol. XIX, p. 19; Udovitch, "*Qirāḍ*", *El*(2), Vol. V, p. 130.

² *Fā'iḳ*, pp. 11 and 339; Ibn al-Athīr, Vol. IV, p. 41; see also Udovitch, "At The Origin of The Western Commenda: Islam, Israel, Byzantium?", *Speculum*, Vol. XXXVII, 1962, pp. 202 -207.

³ Zurqānī, Vol. III, p. 345; Ibn Juzayy, *al-Qawānīn al-Fiqhiyyah*, p. 242.

⁴ *Bidāyah*, Vol. II, p. 303; Jazirī, Vol. III, p. 42.

⁵ *M. Muḥtāj*, Vol. II, p. 309; Shīrāzī, Vol. I, p.505.

⁶ *Hidāyah*, Vol.III, p. 202; *Mabsūṭ*, Vol. XXII, p. 18.

⁷ *Mughnī*, Vol. V, p. 26; *Qinā'*, Vol. III, p. 507.

Indeed, he is regarded as the partner of the investor (*rabb al-māl/ ṣāhib al-māl*) in matters relating to the profit, the capital used on the journey and expenses of an ancillary nature.⁸

The people of Medina called this contract *muqāraḍah* (or *qirāḍ*), based on a report concerning ʿUthmān b. ʿAffān, the third Caliph, who entrusted funds to a man in the form of a *muqāraḍah* contract.⁹ This term derives from *qarḍ* meaning cutting; for in this contract, the investor cuts off the disposition of a sum of money from himself and transfers its disposition to the agent-manager. It is, therefore, designated by that name (*muqāraḍah*).¹⁰ The other term, *muḍārabah*, corresponds to that which is found in the Qurʾān: "While others travel in the land (*yaḍribūna fī al-arḍ*) in search of God's bounty",¹¹ that is to say, travel for the purpose of trade or commerce.¹²

The basis of a *muḍārabah* contract is an offer and acceptance. For example, If the owner of the capital (*rabb al-māl*) says to the person to take the capital and use it and to share the profits between them equally ("Take this capital and do the work and labour in return, on terms that profits are to be divided between us, half and half, or, as two to one") or in ratio of two thirds and one third, or says something indicative of an intention to form a *muḍārabah* as when he asks such person to take

⁸ *Mabsūṭ*, Vol. XXII, p. 18; Cf. Udovitch, "*Qirāḍ*", *El*(2), Vol. V, pp. 129 - 130.

⁹ *Mabsūṭ*, Vol. XXII, p.18; *M. Muḥtāj*, Vol. II, p. 309.

¹⁰ *Mabsūṭ*, Vol. XXII, p. 18; Zurqānī, Vol.III, p. 345; *M. Muḥtāj*, Vol. II, p. 309.

¹¹ Q, 73 : 20.

¹² *Mabsūṭ*, Vol. XXII, p. 18; Cf. *M. Muḥtāj*, Vol. II, p. 309; *Fath Q.*, Vol. VIII, p. 445.

so much money and use it as capital and share the profits with him in a certain ratio and the latter (agent-manager/*muḍārib*) accepts, a contract of *muḍārabah* is concluded.¹³

Generally, *muḍārabah* or *muqāraḍah* connotes a fiducial contract or an arrangement in which an investor (*rabb al-māl*) or group of investors (*arbāb al-amwāl*) entrust capital or merchandise to an agent-manager (*ʿāmil*, *muḍārib*, *muqāriḍ*) who is to trade with it and then, without delay, return to the investor(s) the principal and a previously agreed share of the profits.¹⁴ As a reward for his labour and management, the agent-manager receives the remaining share of the profits.¹⁵ Any loss resulting from the exigencies of travel or from an unsuccessful business venture is borne exclusively by the investor(s); the agent-manager is in no way liable for a loss of this nature, losing only his expended time and effort.¹⁶

The agent-manager's complete freedom under normal trading circumstances from any liability for the capital in the event of partial or total loss and the disjunction between the owners of the capital and third parties are distinctive features of *muḍārabah* and made it an ideal instrument for the purposes of long-distance trade

¹³ Cf. *Maj ʿAdliyyah*, art. 1407.

¹⁴ *Mabsūt*, Vol. XXII, p. 22; *Bidāyah*, Vol. II, p. 303; *M. Muḥtāj*, Vol. II, p. 309; *Fath Q.*, Vol. VIII, p. 447; *Mughnī*, Vol. V, p. 26; Ibn Juzayy, *op cit.*, pp. 242 - 243; Abdur Rahim, *The Principles of Muhammadan Jurisprudence*, Lahore, 1911, p. 324; A. Gaiani, "The Judicial Nature of the Moslem *Qirāḍ*", *East and West*, Vol. IV, (July, 1953), p. 81; A. L. Udovitch, "*Qirāḍ*", *EI*(2), Vol. V, 1980, p. 129.

¹⁵ *Mabsūt*, Vol. XXII, p. 22; Ibn al-Athīr, Vol. III, p. 79; *Tāj*, Vol. I, p. 349; *Muḥallā*, Vol. VIII, p. 247; ʿAlā' al-Dīn al-Samarqandī, *Tuḥfat al-Fuqahā'*, Vol. III, p. 3; Jazīrī, Vol. III, p. 34; *Fath Q.*, Vol. VIII, p. 447.

¹⁶ *Mabsūt*, Vol. XXII, p. 22; *Bidāyah*, Vol. II, p. 303; *M. Muḥtāj*, Vol. II, p. 309; *Mughnī*, Vol. V, p. 58; Jazīrī, Vol. III, p. 34; *Muḥallā*, Vol. VIII, p. 247.

and of obtaining a profitable contract.¹⁷ This type of contract was, therefore, widely recognized and practised in pre-Islamic times and afterwards.

2.2. Legitimacy of *Muḍārabah*

Although the validity of the *muḍārabah* contract is not mentioned in the Qur'ān, Islamic law justifies it on the religious grounds of the traditional practice of the Prophet (*sunnah*), consensus (*ijmā'*) and, more interestingly, on the practical grounds of its economic function in society.

It is unanimously agreed by jurists that the legal validity of the *muḍārabah* contract is derived from the traditional practice of the Prophet.¹⁸ There are numerous traditions which attribute its practice to the Prophet, before his prophethood, and to his leading companions.

According to Ibn Ishaq, the Prophet himself, prior to his prophethood, had acted as an agent-manager in a *muḍārabah* contract with an investment provided by Khadijah bt. Khuwaylid, a merchant woman of dignity and wealth who later became his wife.¹⁹ He took her goods to Syria and traded with them. He sold them at a profit

¹⁷ Udovitch, *Partnership*, p. 171; *Idem*, "Qirāḍ", *El(2)*, Vol. V, 1980, p. 130.

¹⁸ *Bidāyah*, Vol. II, p. 178; *Mughni*, Vol. V, p. 26; *Mabsūt*, Vol. XXII, p. 18; The Shāfi'is add a third traditional ground for the *muḍārabah*'s permissibility, that of analogy (*qiyās*) with the agricultural lease contract, *musāqāt*. See *M. Muḥtāj*, Vol. II, p. 309.

¹⁹ Ibn Ishāq said that Khadijah used to hire men to carry merchandise outside the country for a share of the profits a profit (*muḍārabah*). According to him, when Khadijah heard about the Prophet's truthfulness, trustworthiness and honourable character, she sent for him and proposed that he should take her goods to Syria and trade with them. See Ibn Hishām, *al-Sirah al-Nabawiyyah*, Vol. I, pp. 171 - 172; see also Ṭabarī, *Tarikh al-Rusul wa al-Mulūk*, Vol. II, p. 280; Ibn Hazm, *Jamharat Ansāb al-ʿArab*, ed. unidentified editors, Beirut, 1983, p. 16.

and it amounted to double or thereabouts.²⁰

From this evidence, it appears that this form of commercial association was popularly practised in pre-Islamic trade between the Quraysh and other tribes,²¹ and continued to be practised throughout the early centuries of the Islamic era as the mainstay of caravan and long-distance trade.²²

Another tradition attributed to Muḥammad an unequivocal endorsement and approval of those engaging in trade by means of *muḍārabah*. The Prophet was sent at a time when people were using *muḍārabah* in their dealing and he confirmed them in this practice.²³

ʿĀ'ishah and ʿAbd Allāh b. ʿUmar are reported to have invested the money of orphans and other money left in their safe keeping in *muḍārabah* contracts.²⁴ ʿAbd

²⁰ See refs. no. 18.

²¹ Ibn Hazm, *al-Iḥkām fī Uṣūl al-Aḥkām*, Vol. II, p. 95. For the use of *muḍārabah* in pre-Islamic Arabian trade between the *Quraysh* and other tribes, see M. J. Kister, "Mecca and Tamim", *JESHO*, Vol. VIII, (Leiden, 1965), pp. 117ff.

²² Sālih al-ʿAlī, *Al-Tanẓīmat al-Ijtīmāʿiyyah wa al-Iqtisādiyyah fī al-Baṣrah fī al-Qarn al-Awwal al-Hijrī*, Baghdād, 1953, pp. 242 - 243; ʿAbd al-ʿAzīz al-Dūrī, *Tārīkh al-ʿIrāq al-Iqtisādī fī al-Qarn al-Rābiʿ al-Hijrī*, Baghdād, 1948, p. 121ff; see also. L. Udovitch, "The "Law Merchant" of The Medieval Islamic World", in G. E. Von Grunebaum (ed.), *Logic in Classical Islamic Literature*, Wiesbaden, 1970, pp. 115 - 117; Eric R. Wolf, "The Social Organization of Mecca and The Origin of Islam", *Southwestern Journal of Anthropology*, Vol. VII (4), Albuquerque, 1951, pp. 330 - 337; A. A. Hassan, "The Arabian Commercial Background in Pre-Islamic Times", *IC*, Vol. 61 (2), 1987, pp. 70 - 83; Ziaul Haque, "Inter-Regional and International Trade in Pre-Islamic Arabia", *IS*, Vol. VII (3), 1968, p. 207 - 232; W. M. Watt, *Islam and Integration of Society*, London, 1961, p. 14; S. M. Imamuddin, "Commercial Relation of Spain with Iraq, Persia, Khurasan, China and India in the Tenth Century A. C.", *IC*, Vol. XXXV (3), 1961, p. 177; Raef T. A. Husein, "The Early Arabian Trade and Marketing", *IQ*, Vol. XXX (2), 1986, pp. 109 - 117.

²³ *Mabsūf*, Vol. XXII, p. 19.

²⁴ Al-Shaybānī, " *Kitāb al-Aṣl, Kitāb al-Muḍārabah*", MS. Dār al-Kutub al-Miṣriyyah, *Fiqh Hanafī* 491, fol. 42b, II., pp. 11 - 14 (hereinafter referred to as Shaybanī); *Mabsūf*, Vol. XXII, p. 18.

Allāh b. Masʿūd, a prominent companion of the Prophet²⁵ and al-ʿAbbās b. ʿAbd al-Muṭṭalib, the uncle of the Prophet, engaged in *muḍārabah* contracts,²⁶ the latter having obtained the Prophet's approval for the conditions he imposed upon his agent-manager to whom he entrusted his money.²⁷

Further, according to the Hanafī jurist al-Kāsānī, the practice of *muḍārabah* was carried out by the Companions, and no disapproval was ever stated by the Prophet.²⁸

The above traditions indicate that the Prophet approved of engagement in trade in the form of *muḍārabah*, and this approval amounts to his acknowledgement of the legality of *muḍārabah*. This contract also constituted one of the most widespread tools of commercial activity from the pre-Islamic Arabian caravan trade to the early centuries of the Islamic era.

It has also been noted by the jurists that one of the major reasons for its acceptance is the resulting ease and efficiency achieved in the functioning of the economic system. In this regard, al-Sarakhsī notes that this contract is allowed because "people have a need for this contract. For the owner of capital may not find his way to profitable trading activity, and the person who can find his way to such activity, may not have the capital, and profit cannot be attained except by means of both of these, that is capital and trading activity. By permitting this contract, the goal

²⁵ Shaybānī, fol. 42a, II, pp. 8 - 12.

²⁶ *Mabsūf*, Vol. XXII, p. 18.

²⁷ *Ibid.*

²⁸ Kāsānī, Vol. VI, p. 79; See also Ibn Hazm, *al-Iḥkām fī Uṣūl al-Aḥkām*, Vol. II, p. 95.

of both parties is attained".²⁹

Moreover, this type of business arrangement has a very healthy effect on the position of the labourers. They feel happy and satisfied with the share of the profit. They will feel encouraged to work harder because every increase in the gross profits, increases their share at the termination of business.

2.3. Investment Form

All forms of Islamic partnership capital, with the sole exception of the credit partnership (*sharikat al-wujūh*), require that the investment be on hand (*al-māl hāḍirah*) in order for the contract to be valid and effective. The situation is somewhat more flexible in a *muḍārabah* because the contract is still valid even if the capital is not in the investor's hand but is on deposit with someone or owed to him by another party.³⁰

In the case of deposit, the investor may instruct the agent-manager to collect his money from the depositor and use it as capital for *muḍārabah* or he may directly arrange with the deposittee to change the status of his capital from that of deposit to that of a *muḍārabah* investment.³¹ Similarly, in the case of a debt, the investor may empower the agent-manager to collect it from the debtor and to use the money

²⁹ *Mabsūf*, vol. XXII, p. 19; al- Sawī, *Bulghat al-Sālik*, Vol. III, p. 79.

³⁰ *Mabsūf*, Vol. XXII, p. 29; Wahbah, Vol. IV, p. 845.

³¹ *Mabsūf*, Vol. XXII, p. 29.

collected as a *muḍārabah* investment.³²

It is not permissible if a creditor asks the debtor to use the amount of money owed as a *muḍārabah* investment, because a *muḍārabah* contract cannot be formed with a debt. A *muḍārabah* contract can be formed only on the basis of capital whose origin is absolutely free of liability.³³

Mālikī jurists, on the other hand, consistently reject the conversion of a deposit into a *muḍārabah* investment or the collection of a debt owed to the investor in order to use the collected money as a basis of *muḍārabah* investment. This is because they consistently disqualify the formation of the *muḍārabah* contract from another commercial arrangement such as loans and deposits. In other words, they do not allow any extraneous operations and procedures in the formation of the *muḍārabah* contract.³⁴

Investment in cash.

All jurists are unanimous concerning the eligibility of *dīnārs* (gold) and *dirhams* (silver) currency in whatever shape or form for investment in a *muḍārabah* contract

³² *Ibid*, pp. 29, 58 - 59; Wahbah, Vol. IV, p. 845; This arrangement combines a transfer of debt contract (*hawālah*) with that of *muḍārabah*. *Al-Hawālah*, literally, implies "transfer". Legally, it is an agreement by which a debtor is freed from a debt by another becoming responsible for it, or the transfer of claim of a debt by shifting the responsibility from one person to another. See *Lisān*, Vol. XI, p. 190; Lane, Vol. I, p. 677; *Muḥallā*, Vol. VIII, p. 108; Saḥnūn, Vol. XIII, pp. 288 - 294; *Bidāyah*, Vol. II, pp. 224 - 225; *Fath Q.*, Vol. V, p. 443; *Hash. A.*, Vol. IV, p. 300; *M. Muḥtāj*, Vol. II, p. 193; *Mughni*, Vol. IV, p. 528; *Qināʿ*, Vol. III, p. 370; Schacht, *Introduction*, p. 148.

³³ Shaybānī, *Asl*, fol. 48a; Wahbah, Vol. IV, p. 845.

³⁴ Saḥnūn, Vol. XII, p. 88; *Mukhtaṣar*, p. 189; *Bidāyah*, Vol. II, p. 179; See also Ibn Juzayy, *al-Qawānīn*, p. 243; al-Qurṭubī, *al-Kāfī*, p. 384.

just as in the case of the investment form of partnership contract.³⁵ The validity of a *muḍārabah* contract with *dīnārs* and *dirhams* is accepted because they possess intrinsic value and as such are recognizable as legal tender at all times and in all places.³⁶ It is, therefore, self-evident that they should be eligible for investment in any and all commercial transactions.

Al-Shaybānī, however, on the basis of *istiḥsān* (juristic preference) is of the opinion that a *muḍārabah* contract can be formed with *fulūs* (copper coins) just as with gold or silver currency since the former are currency comparable to *dīnārs* and *dirhams*,³⁷ and because they are in circulation and accepted as currency.³⁸

Based on this consideration, non-circulation copper coins are excluded from eligibility as capital in *muḍārabah* investment. Furthermore, they are held to be commodities and not currency and hence ineligible for *muḍārabah* investment.³⁹

From the above principle, any type of currency that is accepted and recognized as a medium of exchange in the economic transactions is valid for investment in *muḍārabah* contract.⁴⁰ Thus, for example, *zuyūf* and *bahraj* coins⁴¹ were valid for

³⁵ *Mabsūṭ*, Vol. XXII, p. 21; *Bidāyah*, Vol. II, p. 178; *Mukhtaṣar*, p. 189; *N. Minhāj*, p. 154; *Wahbah*, Vol. IV, p. 843; Udovitch, *Introduction*, p. 152; Kāsānī, Vol. VI, p. 82.

³⁶ *Mabsūṭ*, Vol. XXII, p. 21; Kāsānī, Vol. VI, p. 82; *Wahbah*, Vol. II, p. 843; Udovitch, *Partnership*, p. 177.

³⁷ *Mabsūṭ*, Vol. XXII, p. 21.

³⁸ *Ibid.*

³⁹ *Mabsūṭ*, Vol. XXII, p. 21; Mālikī and Shāfiʿī jurists absolutely disqualify copper coins (*fulūs*) for *muḍārabah* contract because they are not accepted as currency. See *M. Muḥtāj*, Vol. II, p. 310; *Saḥnūn*, Vol. XII, p. 86; *Wajīz*, Vol. II, p. 221.

⁴⁰ Kāsānī, Vol. VI, p. 82.

investment in a *muḍārabah* contract because they were accepted as a medium of exchange and a system of currency.⁴² On the other hand, lead *dirhams* was invalid for that purpose since they are counterfeit, spurious coins which was in fact commodities, of the same category as raw lead or raw brass. For this reason they are unacceptable as a medium of exchange for any transaction.⁴³

Investment in goods (*ʿurūd*)

There are two general considerations underlying the rejection of goods and commodities for investment in a *muḍārabah* contract.⁴⁴ The first is the opposition to uncertainty and unjustified enrichment which permeates the entire Islamic law of obligations.⁴⁵ The second consideration is that the object of any contract must be determined (*maʿlūm*), i. e. clearly known and defined.⁴⁶

In explaining the inadmissibility of goods and commodities as capital in a *muḍārabah* contract, al-Kāsānī says that *muḍārabah* with goods leads to uncertainty concerning the amount of the profit at the time of division. This is so because the value of the goods is known only by estimation, chance and conjecture and will differ

⁴¹ The *Lisān al-ʿArab* describes both type of currency as bad and sub-standard dirhams (silver coins). However, *zuyūf* and *bahraj dirhams*, while debased coins of low and poor silver content, were nevertheless accepted for most transactions. *Lisān*, Vol. II, p. 217.

⁴² Kāsānī, Vol. VI, p. 82.

⁴³ Kāsānī, Vol. VI, p. 82.

⁴⁴ For the inadmissibility of goods as capital for *muḍārabah* investment, see *Mabsūf*, Vol. XXII, p. 33; *Muw Y.*, pp. 450 - 451; *Ṣaḥnūn*, Vol. XII, p. 87; Kāsānī, Vol. VI, p. 82; *M. Muḥtāj*, Vol. ii, p. 310.

⁴⁵ Schacht, *Introduction*, p. 114.

⁴⁶ *Ibid*, p. 147; *Wahbah*, Vol. IV, p. 844.

with the difference of those who do the estimating. Furthermore, uncertainty in the value of goods leads to the undesirable possibility of dispute and discord between the investor and the agent-manager.⁴⁷

Besides that, the possible fluctuation in their value may lead to the even more undesirable result of inequitable advantage to one of the parties and disadvantage to the other.⁴⁸ Since the profit in a *muḍārabah* arrangement emerges only after the capital has been returned to the investor, any marked rise in the market value of goods serving as the basis of the *muḍārabah* contract would cancel out any profit for the agent-manager. At the same time, if the market value of the goods dropped, it would put the investor at a disadvantage and provide the agent-manager with unjustified profit.⁴⁹

The legal school which purportedly permitted goods as *muḍārabah* capital is that of Ibn Abī Laylā,⁵⁰ although a similar position is attributed by al-Sarakhsī to Mālik. Mālik said:

Muḍārabah with goods is valid because a commodity is an estimable property which is usually relied upon in trade. As far as the purpose of the *muḍārabah* is concerned, it is equivalent to currency. For just as it is permissible at completion for the capital to be in the form of goods, so it is permissible for it to be in this form at its beginning.⁵¹

However, no source is given for this opinion and in *al-Muwatta'* and in subsequent

⁴⁷ See Kāsānī, Vol. VI, p. 82; see also *Bidāyah*, Vol. II, p. 178; Wahbah, Vol. IV, p. 843.

⁴⁸ Saḥnūn, Vol. XII, p. 87.

⁴⁹ *Mabsūt*, Vol. XXII, p. 33.

⁵⁰ *Ibid*, p. 38; *Bidāyah*, Vol. II, p. 178.

⁵¹ *Mabsūt*, Vol. XXII, p. 33; Cf. Kāsānī, Vol. VI, p.82.

major works, the opposite position is taken. Malik said:

The *qirāḍ* (*muḍārabah*) is valid only if the investment is in the form of either gold or silver. It may not consist of any goods (*ʿurūd*) or merchandise (*silāʿ*).⁵²

According to Mālikī law, as well as in Hanafī law, it is possible to form a *muḍārabah* contract with merchandise and goods by means of a simple legal device, namely that an investor may entrust goods to an agent-manager and instruct him to sell them and use the cash realized from the sale as the capital in a *muḍārabah* investment at a mutually agreed division of the profit.⁵³

This solution all but nullifies the force of the prohibition against goods as capital in the *muḍārabah* contract. The exceptional case is that in which the invested goods are not to be sold, and proceeds of their sale employed in further trade, but are instead to be used in some manufacture or service capacity.

2.4. Conduct of *Muḍārabah*

The most problematic aspects of the operation of the *muḍārabah* received in the legal sources are those concerned with the agent's conduct of *muḍārabah* trade. By far the largest portion of the legal discussion is devoted to elaborating and defining the extent of the agent-manager's freedom of action and clarifying his relationship to the investor and to third parties. These discussions take place within the same

⁵² See *Muw Y.*, p. 448.

⁵³ *Muw Y.*, Vol. II, p. 451; *Mabsūf*, Vol. XXII, pp. 22, 36 - 37; *Saḥnūn*, Vol. XII, p. 87. Al-Khassāf also makes a suggestion that the investor can sell his goods for cash to a party whom he trusts, and then hand over the proceeds to the agent-manager who can immediately repurchase them for a *muḍārabah* contract. see *Kitāb al-Hiyal wa al-Makhārij*. Edited by J. Schacht, Hanover, 1923, p. 27

framework of those concerning the rights and duties of a partner in his conduct of partnership business.

It is interesting to note that there are a number of guidelines on the agent's freedom of actions. Generally, his actions must be consonant with the overall purpose of the contract, namely, that of achieving of profit and it must fall within the bounds of recognized and customary commercial practice.

More specifically, his freedom of action depends on the type of mandate he receives from the investor and whether or not any specific conditions or limitations are imposed at the time the contract is negotiated. An agent's conduct of *muḍārabah* trade can be in the form of a limited or unlimited mandate.

2.4.1. Unlimited *Muḍārabah*

In the case of unlimited *muḍārabah*, the investor (*rabb al-māl*) authorizes the agent to act completely at the latter's discretion in all business matters. Such authorization is conveyed by the investor's statement to the agent: "Act with it (the investment) as you see fit".⁵⁴

There are nine types of business activities authorized to the agent-manager in unlimited *muḍārabah* mandate, as follows;

1. To buy and sell all types of merchandise as he sees fit;
2. To buy and sell for cash and credit;

⁵⁴ *Mabsūṭ*, Vol.XXII, pp. 39 - 40; *Cf. Maj' Adliyyah*, arts. 1416 and 1417.

3. To leave goods as a deposit or pledge (*rahn*);
4. To hire helpers as needed;
5. To rent or buy animals and equipment;
6. To travel with capital;
7. To mingle the *muḍārabah* capital with his own resources;
8. To invest the *muḍārabah* capital in a *muḍārabah* with a third party;
and
9. To invest the *muḍārabah* capital in a partnership (*sharikah*) with a
third party.⁵⁵

In other words, an unlimited *muḍārabah* mandate is when the agent-manager (*muḍārib*) is authorized to do everything necessitated by the *muḍārabah*⁵⁶ in the ordinary course of business or the customary practice of the merchants.⁵⁷ Such a contract does not specify the period, the place of business, the specific time of business, nor the industry or service and the suppliers or customers to be dealt with. Al-Sarakhsī notes that the agent-manager thereby has the right to engage in a *muḍārabah* contract with a third party and to mingle the *muḍārabah* capital with his own capital, because this is the practice of the merchants.⁵⁸

Unlimited *muḍārabah* authorizes the agent-manager to use the widest techniques

⁵⁵ See refs. no. 54, above; For details, see ʿAlī Haydar, *Durar al-Hukkām Sharḥ Majallat al-Aḥkām*, (Translated into Arabic from Turkish by Fahmī al-Husaynī), Baghdad and Beirut, n.d., pp. 465 - 469.

⁵⁶ A loan is excluded from the practice of the merchants, because it is regarded as a favour on the part of the lender, not as a commercial transaction from which some advantage can be expected. See *Mabsūṭ*, Vol. XXII, pp. 39 - 40.

⁵⁷ *Ibid.*

⁵⁸ *Ibid.*; See also Kāsānī, Vol. VI, pp. 7 - 8.

of commerce he may employ in the pursuit of profitable trade. He is permitted to transmit this unlimited mandate to a second agent-manager, and the second agent-manager is equivalent in this respect to the original agent-manager.⁵⁹

This type of unlimited *muḍārabah* contract opens the way for its use as an instrument of financial entrepreneurship. Capital could be entrusted to a well-known and experienced trader (agent-manager) who could then skillfully reinvest it with others, sharing in the profit.

In the absence of any blanket authorization, the agent-manager's freedom of action is somewhat restricted, especially with regard to transactions with third parties. If the investor does not use the phrase, "act according to your judgement" or a substitute phrase conveying the same intention, the agent-manager may engage in all business transactions as long as the goal is the achievement of profit, except in any practice involving mingling the capital with his own resources, investing it in a *muḍārabah* or partnership with a third party.⁶⁰

In this regard, The Mālikis rule that the agent-manager is entitled to invest the capital with any party on *muḍārabah* contract only with the permission of the investor.

Malik spoke about an agent-manager who took *qirād* money from a man (the investor) and then gave it to another man (the second agent-manager) to use as a *qirād* without the consent of the investor. He said : "The agent-manager is responsible for the property. If it is decreased, he is responsible for the loss. If there is a profit, the investor has the stipulation of the profit and then

⁵⁹ *Mabsūf*, Vol. XXII, pp. 39 - 40.

⁶⁰ *Mabsūf*, Vol. XXII, pp. 38 - 39.

the agent-manager has the stipulation of what remains.⁶¹

The Shāfi'is have a different regulations on the question of the two-tier *muḍārabah*, whereby the agent-manager is not allowed to enter into a *muḍārabah* contract with another party regardless of getting express permission or not of the investor. The contract is regarded as void if it has been done.⁶² Despite the general trend of the Shāfi'is school to disallow this kind of arrangement, there are certain Shāfi'i jurists such as al-Shirāzī who held that such practices were be allowed.⁶³

2.4.2. Limited *Muḍārabah*

In a limited mandate *muḍārabah* contract, the agent-manager's freedom of action is regulated by the terms and conditions set by the investor. For example, the agreement may specify the period or the place of business or the specific line of trade or industry or service or the supplier or customers to be dealt with by the agent-manager. The agent-manager must respect those restrictions imposed by the investor. If the agent-manager goes beyond what is permitted and acts contrary to the restrictions imposed, he alone is responsible for the consequences.⁶⁴

Thus, even in a limited mandate *muḍārabah* contract, the agent-manager's freedom of action extends almost unto the commercial horizons in which he functioned. The only criterion for the legitimacy of the agent-manager's actions is the

⁶¹ *Muw Y*, p. 452.

⁶² *Wajiz*, Vol. I, p.223.

⁶³ *Shirāzī*, Vol. I, p. 540.

⁶⁴ *Mabsūṭ*, Vol. XXII, p. 47.

customary practice of the merchants.⁶⁵

This standard is applied with remarkable consistency to all the agent-manager's activities even to the point of bending and adopting rules of law to the requirements of the marketplace. For example, the agent-manager possesses the right to pay off a *muḍārabah* debt with the *muḍārabah* capital, so too does he possess the right to give it as a pledge (*rahn*),⁶⁶ for this is part of the practice of the merchants. In other words, as long as matters are part of the practice of the merchants, the agent-manager's freedom of actions concerning the disposition of the *muḍārabah* capital is in the same category as that the owner of the capital (investor).⁶⁷

Al-Sarakhsī points out that the conditions governing the *muḍārabah* agent-manager's actions differ from those applying to others who are entrusted with the safekeeping and welfare of property other than their own. For example, a guardian of the property of minors is restricted in the disposition of their property to transactions which are unequivocally in the minor's better interests. The guardian or father is not permitted to take risks in disposing of any of their property by accepting

⁶⁵ *Mabsūf*, Vol. XXII, p. 47.

⁶⁶ *Al-Rahn* (security; pledge; pawn) literally means readiness or immutability and durability. It also implies that a thing is inseparable from or tied up with its acquisition, earnings and deeds. (See : J. Schacht, "Rahn", *El(I)*, Vol. III, 1936, p. 1105; *Lisān*, Vol. XIII, pp. 188 - 189; *Tāj*, Vol., XI, p. 221; Lane, Vol. I, pp. 1172 - 1173; Schacht, *Introduction*, p. 8). Legally, *al-Rahn* means to pledge or lodge a real or corporeal property of material value, in accordance with the law as security for a debt or pecuniary obligation, so as to make it possible for the creditor to regain the debt or some portion of the goods or property. See : al-Ṭabarī, *Jamī' al-Bayān*, Vol. XXIX, p. 165; al-Qurṭubī, *al-Jāmi' li Ahkām al-Qur'ān*, Vol. XIX, p. 85; Kāsānī, Vol. VI, p. 135; Origin, p. 186; *Umm*, Vol. III, pp. 141 - 142; Ibn Athīr, Vol. I, p. 422; *I'lam*, Vol. I, p. 478; *Muḥallā*, Vol. VIII, p. 88; *Bidāyah*, Vol. II, pp. 204 - 205; Saḥnūn, Vol. XIV, pp. 296 - 340.

⁶⁷ *Mabsūf*, Vol. XXII, p. 47.

a *hawālah*⁶⁸ with a person who is less prosperous than the purchaser. This is because the transactions of the guardian or father are restricted by the condition of that which is best and most advantageous.⁶⁹ By contrast, a *muḍārabah* agent-manager is not restricted by any similar condition, but only by that which is the customary practice of the merchants.⁷⁰

The Hanafīs' concept of the scope of the agent-manager's freedom of independent action with the *muḍārabah* capital as discussed above is different from other schools of Islamic law. According to the Mālikīs⁷¹ and Shāfi'īs,⁷² the agent-manager's task is the achievement of profit primarily by means of buying and selling for cash. In their view, the right to engage in any other transactions⁷³ does not inhere in the mandate the agent-manager receives from the investor.⁷⁴ In other words, if engaging in any other transactions relating to business without getting prior express permission from the investor, the agent-manager is subject to liability for the investment in case of loss.⁷⁵

⁶⁸ See refs. no. 32, above.

⁶⁹ *Mabsūṭ*, Vol. XXII, p. 47.

⁷⁰ *Ibid.*

⁷¹ *Ṣaḥnūn*, Vol. XII, pp. 103 - 123.

⁷² *M. Muḥtāj*, Vol. II, p. 315.

⁷³ Without the express permission of the investor, the agent-manager is not permitted: (a) to sell *muḍārabah* goods on credit; (b) to accept a *hawālah* in payment for them; (c) to entrust them as a *biḍā'ah* to outside parties; (d) to invest *muḍārabah* capital in a *muḍārabah* or partnership with third parties; and (e) to leave *muḍārabah* capital as a deposit in extreme and extenuating circumstances. See *Ṣaḥnūn*, Vol. XII, pp. 103 - 123; *M. Muḥtāj*, Vol. II, p. 223.

⁷⁴ *Ibid.*

⁷⁵ *Ibid.*

2.4.3. Specific Restrictions

Commenting on business methods, al-Dimashqī said concerning *muḍārabah* that the agent-manager is not bound to indemnify the investor for accidental loss of the investment so long as he does not go beyond the localities agreed upon.⁷⁶

This does not apply to all *muḍārabah*; it is only true for cases in which a geographical limitation on the agent-manager's activities is specifically included in the agreement. There are a number of specific restrictions that the investor could impose on the agent-manager.

These specific limitations could appear in a limited as well as in unlimited mandate *muḍārabah* contract, and could be related to the place, object and method of trade. The only requirement is that the restriction be a "beneficial stipulation", (*sharṭ mufīd*), that is, a useful and beneficial condition from the investor's point of view.⁷⁷

Al-Sarakhsī notes that the imposition of, for example, a geographical restriction fulfils the notion of "beneficial stipulation", since the investor might consider it desirable to have quick and direct access to his capital. In such a case, the agent-manager may not move the capital out of the restricted area or transfer it to anyone

⁷⁶ Abū Faḍl Jaʿfar b. ʿAlī al-Dimashqī, *Kitāb al-Ishārah Ilā Maḥāsīn al-Tijārah wa Maʿrifat al-Aʿrāḍ wa Radiʾihā wa Ghushūsh al-Mudallasīn Fihā*. (Edited and Introduced by Fahmī Saʿd), Cairo, 1983 (First edition 19620), pp. 1 - 30.

⁷⁷ *Mabsūṭ*, Vol. XXII, p. 40.

else who would do so. If he does so, he becomes liable for any loss.⁷⁸

An explicit restriction to work only in a specific market or specific place in the market is construed in an economic and not strictly geographic sense, i. e. as an injunction to trade only at the general price level of that market. In this regard al-Sarakhsī notes:

If the investor (*ṣāhib al-māl*) entrusts him with a *muḍārabah* on a condition that he works with it in the market of Kūfah, and the agent-manager works with it in Kūfah, but not in that place, then according to analogy (*qiyās*) he is a violator and liable because he violated the stipulation imposed upon him by the investor. But by *istiḥsān*, his transactions are effective in *muḍārabah* and he is not liable, because a stipulation which is not beneficial is not taken into consideration, and there is no benefit in confining his transactions to the market, for the investor's intention applies to the price level of Kūfah, not the market itself; in any place in Kūfah in which he transacts business, his transactions conform to that which the investor has stipulated. If the investor instructs him to work with the investment in the changer's market and he work in a different market, or if he instructs him to work in the house of so and so, and he works in some other place, will he be liable? He will not be liable for anything in this connection by reason of the unity of the city.⁷⁹

In addition to this, the investor also has the right to impose restrictions on the agent-manager's trading activity and trade policy. In the case of trading activity, the investor may limit the agent-manager to buying and selling only a specific commodity such as wheat and barley or to a category of merchandise such as textiles, foodstuffs, etc.⁸⁰ The general rule in a restricted *muḍārabah* of trading activity is that

⁷⁸ *Ibid.*

⁷⁹ *Ibid.*, p. 45.

⁸⁰ Shaybānī, fol. 58b; *Mabsūṭ*, Vol. XXII, p. 24.

the agent-manager may do "anything that merchants engaged in that branch of trade do".⁸¹

A restriction by the investor on the agent-manager's trade policy, for example, designate the parties from whom the agent-manager is to buy goods and to whom he is to sell them.⁸² Al-Sarakhsi notes that the imposition of binding restrictions on the agent-manager's trade policy is a "beneficial stipulation" because people differ from one another regarding their trustworthiness and reliability in fulfilling obligations, and the investor has the right to protect his investment by confining the agent-manager's transactions only to people in whom he has confidence.⁸³

2.4.4. Two Agent-Managers.

The basic model for a *muḍārabah* contract is an arrangement between one investor and one agent-manager. There is no barrier, however, to a multiplicity either of investors or of agent-managers in the same contract. In the latter case, the agent-managers are considered as one with respect to the conduct of the *muḍārabah* business. If an investor hands over the capital to two agent-managers, instructing them to "act in it according to their judgement", the agent-managers may act only in accordance with mutual agreement and approval.⁸⁴

⁸¹ Shaybānī, fol. 61a, l. 16.

⁸² If the investor designates the agent-manager to sell only for credit, and not for cash, this restriction is not binding. If the agent-manager then sells for cash, he does not become liable for the capital in his trust, "because he has done better than he was asked. Moreover, al-Sarakhsi says that selling for cash is a more efficacious means of attaining the primary purpose of the *muḍārabah*. *Mabsūf*, Vol. XXII, p. 44.

⁸³ *Ibid*, Vol. XXII, p. 46.

⁸⁴ *Ibid*, p. 44.

According to al-Sarakhsi, if either agent-manager acts independently without his colleague's permission, he becomes liable to the investor for any loss. The rationale underlying this rule, according to him, is that the investor, in choosing two or more agent-managers, is entrusting his capital to their joint discretion, and since "the opinion of one is not like the opinion of two",⁸⁵ no independent unauthorized action on the part of either agent-manager is permissible.⁸⁶

Al-Shaybānī notes that the only circumstance in which one agent-manager can act without his colleague's permission is if he obtains permission from the investor, for "the permission of the investor in this regard and the permission of the other agent-manager are the same".⁸⁷

2.4.5. Purchase and Sale

The agent-manager's freedom to invest and otherwise dispose of the *muḍārabah* capital is predicated on the assumption that this will be done responsibly and reasonably. The agent-manager cannot be held liable for any loss resulting from a reasonable use of the *muḍārabah* funds. If, however, loss results from some unreasonable transaction on the part of the agent-manager, he bears the liability for that loss. In the case of buying and selling *muḍārabah* property (capital), the criterion of reasonableness is that by which people will be fooled.⁸⁸ For example, if the agent-

⁸⁵ *Ibid.*

⁸⁶ *Ibid.*, p. 46.

⁸⁷ Shaybānī, fol. 66b.

⁸⁸ *Mabsūṭ*, Vol. XXII, p. 54.

manager uses £1000.00 to purchase a commodity worth only £500.00 on the market he becomes liable, because the difference between the purchase price and the worth of the commodity is more than that by which people would normally be deceived.⁸⁹

On the other hand, if the agent-manager uses the same sum (£1000.00) to purchase goods worth nine hundred and fifty pounds, he is not held liable for the difference because this is a slight deception (*ghabn yasir*) and is a misjudgement that is easy to make.⁹⁰

The same judgement also applies to the sale of *muḍārabah* goods by the agent-manager, that is, the difference between their original purchase price must not be greater than the amount the people would normally be fooled by; otherwise, the agent-manager is liable for the difference.⁹¹

The Mālikīs do not apply the standard of *ghabn yasir* to the agent-manager's buying and selling activity. According to them, it is expected that he will exercise all the skills necessary to protect the capital entrusted to him. If he is clearly negligent in this respect, he will become liable for any loss that might occur; for example, if an agent-manager purchases some merchandise and pays the seller for it, and then, when he wishes to take possession of the goods, the seller denies that he has received the price from him, the agent-manager becomes liable on the ground that he caused

⁸⁹ *Mabsūf*, Vol. XXII, p. 54.

⁹⁰ *Ibid*; *Mughni*, Vol. V, p. 43.

⁹¹ This opinion is held by Abū Yūsūf, al-Shāfi'ī and al-Shaybānī. Abū Hanīfah, however, is of the opinion that any sale by the agent-manager is valid and binding on the *muḍārabah*. See Shaybānī, fol. 70a; *Mughni*, Vol. V, p. 43.

the loss of the investor's capital by failing to have the sale witnessed when he paid the price.⁹²

From the above, it is apparent that any other clear-cut cases of negligent and careless business transaction would also make the agent-manager liable.

The agent-manager who is regarded as "representative in trade" possesses the full range of options that any buyer or seller trading with his *muḍārabah* capital would have. In this regard, if the agent-manager sells some merchandise in which the purchaser finds a fault, he has the right:

- a. to deny that the fault exists;
- b. to contest it, claiming that the fault came about after the goods were sold; and
- c. to appease the buyer either by reducing the price or by offering him additional goods.⁹³

In the case of absence of any fault or claim of fault from the buyer, the agent-manager cannot offer a reduction from the regular price because according to al-Shaybānī, this is not part of trade; it is rather in the category of gift.⁹⁴ If he does so, he becomes liable and accountable to the investor, and the amount of the reduction

⁹² Saḥnūn, Vol. XII, p. 123.

⁹³ *Mabsūṭ*, Vol. XXII, p. 57.

⁹⁴ See Al-Shaybānī, fol. 64b, l.6. A gift is defined as an immediate and unqualified transfer of ownership of a determinate object in the lifetime of the transferor without an equivalent (*ʿiwaḍ*). See for example, *M. Muḥtāj*, Vol. II, p. 396; *Hash. A.*, Vol.IV, p. 530; *Fath Q.*, Vol. V, p. 113; *Bidāyah*, Vol. II, p.248 - 249; Vesey-Fitzgerald, S., *Muhammadian Law : An Abridgement*. Oxford and London, 1931, p. 201.

is regarded as a debt of the agent-manager to the investor.⁹⁵

2.4.6. Expenses.

The agent-manager is allowed to deduct all legitimate business expenses from the capital entrusted to him to cover his personal needs such as food and clothing. The limits of his freedom of deduction of *muḍārabah* capital are defined by its conformity to the two criteria of customary commercial practice and the pursuit of profit. The entire discussion of an agent-manager's personal expenses assumes that he will, in fact, travel on behalf of the *muḍārabah* investment. If the agent-manager does not travel with the investment, but stays in his native town or with his family, he is not entitled to cover any of his personal expenses from *muḍārabah* funds.⁹⁶ Since he does not travel with it, his personal expenses are to be borne by himself.⁹⁷

On the other hand, if the agent-manager travels with the *muḍārabah* capital entrusted to him to another place for the purpose of trading with it, then all his personal expenses such as clothing, food and the cost of travel are to be taken from the *muḍārabah* investment.⁹⁸ The duration of the travel and sojourn may last from six months to several years or only from one to three days.⁹⁹ In other words, the duration of the travel of agent-manager depends on the completion of the business purposes.

⁹⁵ *Mabsūṭ*, Vol. XXII, p. 47.

⁹⁶ See *Bidāyah*, Vol. II, p. 181; al-Qayrawānī, *al-Risālah*, p. 477.

⁹⁷ Shaybānī, fols. 76a.10 - 76b. I. I; *Mughnī*, Vol. V, pp.41-42.

⁹⁸ *Hash. A.*, Vol.IV, p. 512; Kāsānī, Vol. VI, p. 106; *Bidāyah*, Vol. II, p. 181; *Qināʾ*, Vol. II, p. 265.

⁹⁹ *Mabsūṭ*, Vol. XXII, pp. 62 - 63; *Mughnī*, Vol. V, p. 64.

The rationale behind this procedure is custom, for the agent-manager's departure and travel are on behalf of the *muḍārabah* capital. He may not normally undertake this kind of hardship for the sake of an uncertain profit which he may or may not achieve, and then pay his personal expenses from his own money. However, he is willing to undertake such hardship with a view to the benefit that might accrue to him. This will not come about except by taking the sufficient personal expenses from the *muḍārabah* investment.¹⁰⁰

The explanation of the agent-manager's right to personal expenses from the *muḍārabah* investment reflects one of the basic features of the contract which make it a practical and efficient instrument for profitable long-distance trade and business.

While every agent-manager in a *muḍārabah* contract is entitled to have his expenses for food, clothing and cost of travel covered by the *muḍārabah* capital by virtue of commercial custom, the quality of the food and clothing, and the comfort with which he travels are determined by his social status.¹⁰¹ Examples of how the agent-manager's social status affect his expenses are not elaborated in the legal texts. Nevertheless, the social and commercial standing of the agent-manager must have been of considerable practical importance vis a vis his expenses.

The jurists are thoroughly consistent in their view of the division of the risks and investment in the *muḍārabah* contract and it must be carried out to its ultimate conclusion. In this regard, al-Sarakhsī responds that if the agent-manager is not given

¹⁰⁰ *Mabsūf*, Vol. XXII, pp. 62 - 63; Wahbah, Vol. IV, p. 865.

¹⁰¹ Saḥnūn, Vol. XII, pp. 92 - 94; *Mabsūf*, Vol. XXII, p. 63; Wahbah, Vol. IV, p. 866; Udovitch, *Partnership*, p. 233.

his personal expenses from the *muḍārabah* capital while engaged in trade and travel on behalf of the *muḍārabah* investment, the distribution of risks between the parties involved would be less equitable. As a result, the *muḍārabah* arrangement will become a less attractive and practical instrument for combining the capital and skills necessary for the success of the business and trade.¹⁰²

2.4.7. Invalid *Muḍārabah*

Any invalid *muḍārabah* (*muḍārabah fāsidah*) is treated as a hire contract (*ijārah*); all profits accrue to the investor and all losses are borne by him.¹⁰³ The agent-manager's personal expenses, but not his business expenses are borne solely by him, who in turn, as an employee, is entitled to an equitable wage (*ajr al-mithl*).¹⁰⁴

The grounds for declaring a *muḍārabah* invalid are numerous, and can be connected with almost any aspect of the contract. These include provisions for a non-proportional division of profit, non-alienation of the investment on the part of the investor (*ṣāhib al-māl*), the agent-manager's violation of a legitimate restriction placed on him by the investor, as well as many other circumstances. In all such cases, the nature of the contract, i.e. the relationship of the parties involved has been transformed. The investor's position becomes that of an employer and he is responsible for his goods and property and all profit from the investment fully

¹⁰² *Mabsūṭ*, Vol. XXII, p. 67; Cf. *Ṣaḥnūn*, Vol. XII, pp. 92-94.

¹⁰³ *Al-Dardīr*, *Al-Sharḥ al-Kabīr*, Vol. III, p. 519; *Kāsānī*, Vol. VI, p. 108; *Mabsūṭ*, Vol. XXII, p. 22; *Mughnī*, Vol. V, p. 65; *M. Muḥtāj*, Vol. II, p. 315; *Hidāyah*, Vol. I, p. 388.

¹⁰⁴ *Mabsūṭ*, Vol. XXII, p. 67; *Fatḥ Q.*, Vol. VII, p. 60; *al-Dardīr*, *al-Sharḥ al-Kabīr*, Vol. III, p. 517; *M. Muḥtāj*, Vol. II, p. 313; *Mughnī*, Vol. V, p. 34; *al-Ramlī*, *Nihāyah al-Muḥtāj ilā Sharḥ al-Minhāj*, Vol. IV, Cairo, 1967, p. 165.

accrues to him. On the other hand, the agent-manager's role is changed to that of a simple employee and he is entitled to remuneration for his time and effort regardless of whether his exertions on behalf of his employer are successful.¹⁰⁵

2.4.8. Dispute Between Parties

If the agent-manager claims, without any evidence, that he has brought the profits with the capital, the statement or testimony of the investor who claims that the agent-manager has not yet returned the capital is accepted and the latter is entitled to receive his capital. This, however, does not apply if the agent-manager is able to provide evidence in support of his claim. In the latter case, the claim of the agent-manager will be accepted.¹⁰⁶

The claim of breach of contract by the investor or of being afflicted by a disaster by the agent-manager is not accepted until evidence is produced.¹⁰⁷ If the agent-manager transgresses the contract, he is liable for repaying or replacing the capital to the investor. It is considered that liability for repayment or replacement falls on the agent-manager because he has been trusted to carry out the work.¹⁰⁸ In this case, if profits have been accrued in the business, they are to be shared as originally agreed by both parties.¹⁰⁹ It is also held that neither of them has the right to retain the

¹⁰⁵ *Mughni*, Vol. V, p. 72; *Wahbah*, Vol. IV, pp. 851 - 852.

¹⁰⁶ *Muṣannaf*, Vol. VIII, p. 251; *Muḥallā*, Vol. VIII, p. 249; *Kāsānī*, Vol. VI, p. 107; *Mabsūṭ*, Vol. XXII, pp. 20 and 105; *Mughni*, Vol. V, p. 54; *Ḥaṣh A.*, Vol. IV, p. 511.

¹⁰⁷ *Muṣannaf*, Vol. VIII, p. 252.

¹⁰⁸ *Saḥnūn*, Vol. XII, p. 116; *Mughni*, Vol. V, pp. 54 and 77; *Muṣannaf*, Vol. VIII, pp. 252 - 253 & 255.

¹⁰⁹ *Mughni*, Vol. V, p. 54; *Muṣannaf*, Vol. VIII, p. 252.

profits from the venture in order to avoid further disagreement between the parties.¹¹⁰

If the investor sets conditions such as that the agent-manager should not make a transaction involving certain conditions, and then the latter does not follow these instructions for the best interest and benefit of *muḍārabah* transaction, he is not liable for any repayment or replacement of the capital.¹¹¹

2.5. Distribution of Profits and Liability for Loss

2.5.1. The Proportional Division of Profits.

The condition concerning how the proportion of the share of profits in a *muḍārabah* contract is to be divided between the parties involved is on the basis of mutual agreement. Juridical precedent for these conditions is reported by Ibn Ishāq. According to him, Khadījah proposed to the Prophet, before his prophethood, that he should take her goods to Syria (al-Shām) and trade with them. She agreed that she would pay him more than she paid others.¹¹² This is evidence that the distribution of profits in *muḍārabah* contract between the investor and the agent-manager is in accordance with what has been agreed upon by both parties at a specific point in time.

This action was later conventionally recognized and followed in the case of

¹¹⁰ *Ibid.*

¹¹¹ *Mughni*, Vol. V, p. 54.

¹¹² Ibn Hisham, *al-Sirah al-Nabawiyah*, Vol. I, p. 172.

muḍārabah contracts. The proportional division of profits was followed and continued by the Companions. ʿUmar b. al-Khaṭṭāb, the second Caliph, made a contract of *qirāḍ* (*muḍārabah*) with his sons, ʿAbd Allāh and ʿUbayd Allāh, by taking the principal or capital and a half of the profit and giving them the other half of the profit.¹¹³ ʿUthmān b. ʿAffān, the third Caliph, used to provide some money to his agent-manager (*muḍārib*) in a *qirāḍ* transaction and they shared the profit between them.¹¹⁴ ʿAlī b. Abī Ṭālib was of the opinion that the proportional division of profit should be divided in accordance with what had been agreed by the two parties in the contract (*al-ribh ʿalā al-muṣṭalahā ʿalayh*).¹¹⁵

In the *fiqh* literature, it is stated that all jurists are unanimous concerning the distribution of profits in a *muḍārabah* contract. They held that any proportional division of profit agreed upon between an investor and agent-manager is acceptable.¹¹⁶ The only requirement of a valid *muḍārabah* contract is that the profit should be distributed between both parties on the basis of proportions agreed upon by them in advance as simple proportions of profit, i. e. one-half, one-third or one-fourth, or a percentage, for example, 50 : 50; 70 : 30; 40 : 60 and 25 : 75.¹¹⁷

¹¹³ *Muw* Y, p. 446; *Umm*, Vol. IV, pp. 34 - 35; Suyūṭī, *Tanwīr al-Hawālik*, Vol. II, p. 88; Cf. Muzanī, Vol. VIII, p. 221.

¹¹⁴ *Muw* Y, p. 447; Suyūṭī, *Tanwīr*, Vol. II, p. 88.

¹¹⁵ *Muṣannaf*, Vol. VIII, p. 248; Ibn Abī Shaybah, *al-Muṣannaf*, Vol. IV, p. 268; *Muḥallā*, Vol. VIII, p. 126; Cf. *Mughnī*, Vol. V, pp. 30 - 31.

¹¹⁶ Jazīrī, Vol. III, discussion on *muḍārabah*, (Hanafī view), p. 37; (Mālikī view), p. 37; (Shāfiʿī view), p. 46; (ḥanbalī view), p. 43.

¹¹⁷ Zurqānī, Vol. III, p. 158; *Mughnī*, Vol. V, pp. 30 - 31; *Bidāyah*, Vol. II, p. 303; al-Nawawī, *al-Majmūʿ*, Vol. IX, pp. 64 - 65; *S. Mizan*, Vol. II, p. 92; al-Dardīr, *al-Sharḥ al-Saghir*, Vol. II, p. 327.

If either party fixes a certain amount of profit for himself instead of a proportional share of profit, for example £1000.00 out of profit or less than that or more than that, and the rest is for the other party, the *muḍārabah* contract will stand nullified.¹¹⁸ The reason given is that such an arrangement easily leads to an inequitable situation in which one party would get most or all the profits and the other little or none.¹¹⁹

If a *muḍārabah* contract is regarded as invalid because of either party fixing a certain amount of profit, it is treated as regular hire (*ijārah*).¹²⁰ In this case, the agent-manager is entitled to an equitable remuneration (*ajr mithlihi*) for his work, but thereby disqualified from any share in the profit.¹²¹

According to Mālikī law, if one person supplies capital to another in a *muḍārabah* arrangement and agrees that some of the profit will be exclusively for himself and not for the agent-manager, the arrangement will not be valid, even if the sum were fixed at only one dirham. The only valid form of agreement is that he agrees to one-half or one-third or one-fourth or smaller than it or larger than it, for

¹¹⁸ *Ibid.*

¹¹⁹ *Mabsūf*, Vol. XXII, p. 22.

¹²⁰ *Ijārah*, literally, means substitute, compensation, recompense, idemnity, consideration, return or counter value (*‘iwāḍ*). (See : Lane, Vol. I, p. 24; E. Tyan, "*Idjāra*", *El(2)*, Vol. III, 1978, p. 1017). In Islamic law, *ijārah* is a contract of proposed and known usufruct with a specific and lawful return or compensation for the effort or work which has been expended). See : al-Qaṣṭallānī, *Irshād al-Sāri*, Vol. IV, p. 126; Zurqānī, Vol. III, p. 368; Muw Y, p. 578; Muḥallā, Vol. VIII, pp. 182 - 183; Umm, Vol. IV, p. 26; Kāsānī, Vol. IV, p. 174; al-Qurṭubī, *al-Jāmi‘ li Aḥkām al-Qur’ān*, Vol. XIII, pp. 270 - 271; Schacht, *Introduction*, p. 154; Coulson, *Commercial Law*, p. 22; M. Muḥtāj, Vol. II, p. 338; al-Qarāfī, *al-Furūq*, Vol. IV, p. 4; Muḡhni, Vol. V, p. 398; Qinā, Vol. III, p. 537; Hash A., Vol. IV, p. 110; Awjār, Vol. V, p. 146.

¹²¹ Shaybānī, fol. 43b, II. 13 - 14.

himself and the remainder for the agent-manager.¹²² In this regard, al-Ghazālī, the Shāfi'ī jurist, says:

If any of the two parties settles for a fixed sum of *dirhams* under *Sharikah* (partnership) or *muḍārabah* it shall not be legitimate.¹²³

The provision of profit in the *muḍārabah* agreement must be clearly spelled out. However, Hanafī jurists exhibit a degree of flexibility in this regard, and validate some such arrangements on the basis of *istiḥsān*.¹²⁴ For example, if a *muḍārabah* agreement mentions only the investor's share of the profit, but not that of the agent-manager, it is acceptable on the basis of *istiḥsān* and the remainder of the profit is distributed to the agent-manager.¹²⁵

If no definite division of profit is mentioned, but the investor merely says to the agent-manager, "On the condition that whatever God, may He be exalted, grants us

¹²² Saḥnūn, Vol. XII, p. 109.

¹²³ *Wajiz*, Vol. I, p. 187; This is also the opinion of other Shāfi'ī jurists that, when one party provides capital and the other employs it in business : "it is necessary that the profit be reserved for them alone and that they share it..... the share of every party is fixed as a given proportion of the whole ... if ten (*dirhams*) have been agreed for one party, or if profit is agreed for him out of the gains from some particular merchandise, the agreement shall become void". See for example *Minhāj* N, pp. 64 - 65.

¹²⁴ *Istiḥsān*, literally, means to approve or to deem something preferable. In its juristic sense, *istiḥsān* (juristic preference) is a method of exercising personal opinion in order to avoid any rigidity and unfairness that might result from the literal enforcement of the existing law. It involves a departure from *qiyās* in favour of an alternative ruling which serves the ideals of justice and public interest in a better way or dispels hardship (*raf' al-ḥaraj*) and brings about ease to the people in achieving the objectives of the *Sharī'ah*. The departure to an alternative ruling in *istiḥsān* may be from an apparent analogy (*qiyās jali*) to a hidden analogy (*qiyās khafi*), or to a ruling which is given in a *nass*, i. e. the Qur'ān or the Sunnah or the Consensus of community (*ijmā'*) or custom of public interest. See Ibn al-ʿArabī, *Aḥkām al-Qur'ān*, Vol. II, Cairo, 1350 A. H., p. 57; Al-Shāṭibī, *al-Muwāfaqāt fī Uṣūl al-Sharī'ah*, Cairo, n. d., p. 208; Al-Ghazālī, *al-Mustaqfā min ʿIlm al-Uṣūl*, Vol. I, Cairo, 1937, pp. 137, 138 - 139; al-ʿAmidī, *al-Iḥkām fī Uṣūl al-Aḥkām*, Vol. IV, 1982, p. 157; Abū Zahrah, *Uṣūl al-Fiqh*, Cairo, 1958, p. 207; Khallāf, *ʿIlm Uṣūl al-Fiqh*, Kuwait, 1978, p. 82; Agnides, *Mohammedan*, p. 73; Ahmad Hasan, *The Early Development of Islamic Jurisprudence*, Islamabad, 1970, pp. 145 and 352; R. Paret, "Istiḥsān and Istiṣlāḥ", *El(2)*, 1978, p. 256.

¹²⁵ Shaybānī, fol. 45a.

will be between us", or if he says, "On the condition that we be partners in the profit", then the *muḍārabah* contract is valid and the profit is distributed equally between them.¹²⁶ Any unassigned portion of the profit will automatically revert to the investor since it is profit on his capital. So, for instance, if one-half is agreed upon to be distributed to the investor and one-third to the agent-manager, and no mention is made of the disposition of the remaining one-sixth of the profit, it is given to the investor.¹²⁷

A multiplicity of agent-managers or investors in one *muḍārabah* contract does not affect the principle of profit-sharing, as long as the flexibility of the proportion of the division of the profit is assigned as in a simple *muḍārabah* contract, i. e. with one investor and one agent-manager.¹²⁸ In a *muḍārabah* contract with a multiplicity of agent-managers, it is assumed that each of them will invest an approximately equal amount of work and receive between them, an equal share of profit. This principle is applied in order to avoid one agent-manager receiving unjust profit from the work of his colleague.¹²⁹

However, in the case of a bilateral *muḍārabah*, i.e. one in which both the agent-manager and the investor contribute to the trading capital, the flexibility in assigning the division of the profit is somewhat restricted. The investor's share must be limited only to his contribution to the total capital, since there is no basis on which he can

¹²⁶ *Mabsūf*, Vol. XXII, pp. 54 - 55; This is the opinion of Abu Yūsūf; On the other hand, al-Shaybānī disagrees considering such an agreement invalid and treating it as a hire contract (*ijārah*). *Ibid*.

¹²⁷ *Saḥnūn*, Vol. XII, pp. 89 - 90.

¹²⁸ *Shaybānī*, fols. 49b - 50b.

¹²⁹ *Saḥnūn*, Vol. XII, p. 90.

claim profit on capital he did not invest and with which he did not work. On the other hand, the agent-manager is entitled to the entire profit on his own share of the capital in addition to a share of the profit from the investor's contribution (investment).¹³⁰

2.5.2. Liability for Loss

Loss refers to a diminution or destruction of part of the property or capital and will therefore be borne by the supplier of the capital (investor ; *sāhib al-māl*).¹³¹ In the event of loss incurred in the *muḍārabah* contract in the ordinary course of business, it must be charged against profits before it can be charged against the equity of the investor.¹³²

The concept of the agent-manager as a trustworthy party (*amin*) is the cornerstone upon which the structure of equity within the *muḍārabah* contract rests. He is required to work with honesty and sincerity and to exercise the maximum possible care and precaution in the exercise of his functions.¹³³ Any arrangement

¹³⁰ Al-Dardir, *al-Sharḥ al-Saghīr*, Vol. II, p. 231; Jazīrī, Vol. III, p. 69.

¹³¹ *Mabsūṭ*, Vol. II, pp. 156-157; *Bidāyah*, Vol. II, p. 178; *Mughnī*, Vol. v, p. 38; *M. Muḥtāj*, Vol. II, p. 309; al-Shaybānī, *al-Makhārīj fī al-Hiyāl*, p. 76; see also Aḥmad al-Sharbāsi, *al-Muʿjam al-Iqtiṣādī al-Islāmī*, Cairo, 1981 p.131.

¹³² Muw Y., p. 448; *M. Muḥtāj*, Vol. II, p. 309.

¹³³ In the words of al-Jazīrī, the agent-manager should discharge his duties like "A muslim who does not commit a breach of trust, does not lie and does not act insincerely; such is the man with whom the investor will be at ease and in whom he will have confidence for the safety of his investments..... The investor should not give his capital (funds) to someone who is unwary, spendthrift or untrustworthy, because the care and safety of wealth are imperatives and its waste and dissipation are prohibited". See Jazīrī, vol. III, pp. 48 - 49.

involving the agent-manager's liability for the loss would be void and unenforceable.¹³⁴

The general principle is that under a *muḍārabah* contract, a working partner (agent manager/ *muḍārib*) who is not investing his capital in the business is not liable for any loss.¹³⁵ This means that the investor gets the profit by risking his capital in the venture while the agent-manager gets the profit by risking his time and effort. This is probably the reason why *muḍārabah* is sometimes referred to as "partnership in profit" or "profit-sharing".¹³⁶

There is no difference of opinion among jurists regarding the liabilities for loss in *muḍārabah* contracts. The Mālīkīs,¹³⁷ Hanafīs,¹³⁸ Shāfi'īs¹³⁹ and Hanbalīs¹⁴⁰ are unanimously agreed on the principle that the man who actually engages in business (*ʿāmil*; *muḍārib*;) will not be made liable for the loss of any part of the capital invested, on condition that the loss is not due to any misdeed on his part.¹⁴¹

¹³⁴ *Mughni*, Vol. V, p. 76; *Bidāyah*, Vol. II, p. 178.

¹³⁵ *Muw* Y., p. 450.

¹³⁶ See the suggestion and comment made by M. N. Siddiqui on "The Report of The Pakistan Council of Islamic Ideology on The Elimination of Interest from The Economy", in Ziauddin Ahmad, et. al.(eds.), *Money and Banking In Islam*, Islamabad, 1983, p. 225.

¹³⁷ See *Bidāyah*, Vol. II, p. 178; see also *Zurqānī*, Vol. III, p. 158.

¹³⁸ *Mabsuṭ*, Vol. XI, pp. 156-157; For a greater details given by Hanafī jurists, see *Kāsānī*, Vol. VI, pp. 82-84; *Hidāyah*, Vol. III, pp. 202-215.

¹³⁹ See for example *M. Muḥtāj*, Vol. II, p. 309; *Minhaj* N., p. 156.

¹⁴⁰ *Mughni*, Vol. V, p. 38.

¹⁴¹ *Bidāyah*, Vol. II, p. 178; *M. Muḥtāj*, Vol. II, p. 309; *Mabsuṭ*, Vol. XI, pp. 156-157; *Jazīrī*, Vol. II, p. 34; *Mughni*, Vol. V, p. 38.

Behind this principle lies the idea of justice and fairness for the purpose of labour and business efforts joining hands with capital invested by the investor. The penalty for causing a loss to the invested capital cannot justly be charged to the party making the business effort. The agent-manager's loss lies in the fact that the failure to add to the invested capital denies him all rewards for his business and management efforts which have been wasted.

Once the original investment has increased as a result of the agent-manager's activities, the latter is considered a part-owner (*sharik*) of the capital even if the *muḍārabah* is still ongoing. The agent-manager's ownership consists of that sum which would constitute his share of the profit were the *muḍārabah* to be concluded at that moment. Consequently, in the case of loss, the agent-manager, not the investor, would be liable for the share.¹⁴²

The liability of the investor (*ṣāhib al-māl*) in a *muḍārabah* contract is limited to the extent of his contribution to the capital only.¹⁴³ This is an important point because it would not be appropriate for the investor to be a 'sleeping partner' if his liability were unlimited.¹⁴⁴

As a matter of precaution, in order to ensure that the investor's liability does not exceed the sum he has entrusted to the agent-manager, the agent-manager's trading activities may be placed under certain restrictions. For example, the agent-manager

¹⁴² *Ṣaḥnūn*, Vol. XII, p. 99.

¹⁴³ *Mughni*, Vol. V, p. 37 - 38 & 68.

¹⁴⁴ *Ibid.*

is not allowed to amplify or negotiate a loan for *muḍārabah* (*istidānah*; incurrence of debt).¹⁴⁵

If the agent-manager exceeds these bounds by, for instance, negotiating a loan (*istidānah*)¹⁴⁶ for *muḍārabah* over and above the capital invested by the investor, he alone becomes liable for any sum in excess of the *muḍārabah* capital and he is also eligible for all the profits from his extra *muḍārabah* commitment.¹⁴⁷

Besides that, the agent-manager cannot, at the *muḍārabah's* expense, alter or improve any of the goods he has purchased if their acquisition alone has required all the available capital.¹⁴⁸ For example, if he invests the entire amount of capital in cloth and then improves it by having it dyed or otherwise, he is regarded as having altered the *muḍārabah's* expense.¹⁴⁹

The agent-manager is allowed to do *istidānah* (that is to incur debt in excess of the *muḍārabah* capital) only with an express authorization by the investor. However, there is a difference between the status of goods (merchandise) bought with the actual *muḍārabah* capital and those procured above that amount. Goods bought on the basis of credit authorized by the investor, above and beyond the total amount of *muḍārabah* capital are not subject to the principle of ownership and liability in

¹⁴⁵ *Mabsūf*, Vol. XXII, p. 75.

¹⁴⁶ *Istidānah* is the commercial commitment of the *muḍārabah* by the agent-manager in excess of the capital entrusted to him by the investor.

¹⁴⁷ *Saḥnūn*, Vol. XII, pp. 94-97.

¹⁴⁸ *Saḥnūn*, Vol. XII, 94-97.

¹⁴⁹ *Mabsūf*, Vol. XXII, p. 75.

muḍārabah contracts.¹⁵⁰ The ownership, risk and profit are jointly shared by the investor and agent-manager, thus in practice constituting a credit partnership.¹⁵¹

Based on the above discussion, it can be said that with the investor's authorization to engage in *istidānah*, the agent-manager would be in a position to take advantage of various promising commercial opportunities that might require a larger volume of capital than that furnished by the investor. By using the actual *muḍārabah* investment as a base, he would probably find himself in a more favourable position to obtain credit and thus to increase the profitable returns of the business.

If the agent-manager also contributes a specified amount to the capital of the *muḍārabah*, he takes the entire profit related to his portion of the total capital, the balance of the profit being as agreed. The loss, if any, would be divided between them in proportion to their share in the total capital.¹⁵²

2.5.3. Method of Settlement of Accounts

All jurists agree that normally the profit or loss in a *muḍārabah* arrangement is to be determined at the termination of the business, that is after the settlement of the accounts and the original capital has been set apart.¹⁵³ There is also no difference of

¹⁵⁰ Shaybānī, fol. 175b, ll. 9ff.

¹⁵¹ See, A. L. Udovitch, "Credit as a means of Investment in Medieval Islamic Trade", *JAOS*, Vol. 87, 1967, pp. 260-264; *Idem*, "Reflections on The Institutions of Credit and Banking In The Medieval Islamic Near East", *SI*, Vol. 41, 1975, pp. 5 - 23.

¹⁵² Jaziri, Vol. III, p. 69.

¹⁵³ *Bidāyah*, Vol.II, p. 181; *Mughni*, Vol.V, p. 57; *Mabsūt*, Vol.XXII, p. 20; *Wajiz*, Vol.I, pp. 225-226; Jaziri, Vol. III, pp. 61 - 62.

opinion among jurists that the agent-manager (*muḍārib*) takes his share of the profit only when all the capital invested in the enterprise has been repaid to the investor (*rabb al-māl*) in the form of cash¹⁵⁴ or in the form of a legal transfer.¹⁵⁵

The question arises here whether it is legitimate or not to share out any profit that appears before the termination of business, and whether any profit so shared out becomes wholly and permanently the property of the party to whom it is given or is only temporarily his property. In this regard, the majority of jurists hold that profit is recognised and its ownership is proved only after the termination of business, the settlement of accounts and the originally-invested capital has been returned to the investor¹⁵⁶ Accordingly, it is illegitimate to share out any profit that appears (in the running business) before the settlement of accounts.

The principle mentioned is that the validity of distribution of profit is conditional upon the repossession of the investor's original capital. Hence, the distribution of profit before the repossession of the original investment by the investor is invalid. If profit has been declared before this, any such distribution would be taken as only an interim arrangement.¹⁵⁷ The distribution of such profit would become valid only after the investor's original capital had been repaid, otherwise it could be treated as void.¹⁵⁸

¹⁵⁴ *Bidāyah*, Vol. II, p. 181; *Mughnī*, Vol. V, p. 57.

¹⁵⁵ ʿAlī al-Khafīf, *al-Sharikāt fī al-Fiqh al-Islamī*, p. 86.

¹⁵⁶ This is the opinion of the majority of jurists. See, for example *Bidāyah*, Vol. II, p. 181; Jazirī, Vol. III, pp.61-62 ; Kāsānī, Vol. VI, p. 107; *Mabsūf*, Vo. XXII, p. 20.

¹⁵⁷ Jazirī, Vol. III, pp. 61 - 62.

¹⁵⁸ *Ibid.*

Ḥanbalī jurists also agree with the principle stated above with minor differences of emphasis. In their view too, profit should be distributed on the termination of business and after the invested capital has been repaid to the investor (*rabb al-māl*).¹⁵⁹ They, however, find that there is no fault if profit accrues during the running of business, and with the consent of the investor, the agent-manager is given some instalment of profit on an ad hoc basis.¹⁶⁰ If there is a loss in the final accounting, the agent-manager may, in order to make it good, have to surrender the ad hoc payment of profit to the investor.¹⁶¹

In a case, where, in a *muḍārabah* contract, profit has been shared out while the working partner is still in possession of the originally-invested capital and that *muḍārabah* contract is terminated and replaced by a new *muḍārabah* contract, at this point the share out of profit already effected would be regarded as final and the agent-manager would not be required to return what had been paid to him.¹⁶²

In this regard, the author of the *Hidāyah* writes:

If *muḍārabah* operates as usual but the parties have distributed profit and after that a part of the capital is lost, both must return the profit, so that the capital-owner (investor) may be repossessed in full of his investment. Distribution of profit before repayment of invested capital is not correct. That is because capital is the basis of profit which rests upon it and profit is subject to capital.¹⁶³

¹⁵⁹ *Mughnī*, Vol.V, p. 57.

¹⁶⁰ *Ibid.*

¹⁶¹ *Ibid.*; ‘Alī al-Khafīf, *al-Sharikāt fī al-Fiqh al-Islāmī*, p. 86.

¹⁶² Jazīrī, Vol. III, p. 61-62.

¹⁶³ *Hidāyah*, Vol. III, pp. 209 - 210.

Some modern scholars¹⁶⁴ opine that in the case of a *muḍārabah* contract continuing in operation for a long time, it would be easier and in the interest of the parties themselves for the distribution of profit to be permitted before the termination of the business, especially if the agent-manager is not able to continue the business, (possibly his only source of income), if he gets nothing out of it for a long time.

From the above discussion, it is clear that there is nothing wrong if *muḍārabah* business is showing profit and some amounts are taken out of the profit with the permission of the investor. This provisional payment given to the agent-manager is subject to the final settlement of claims at the termination of the business.

The parties entitled to profit from a *muḍārabah* business can claim their mutually agreed share of profit only when the investor who supplied the original capital has had his investment returned to him in full, whether in the form of cash or in the form of legal transfer.¹⁶⁵

Accordingly, the notion of restoration of the original capital to the investor before the profit is to be distributed to the parties involved in a *muḍārabah* contract is the transformation of that original capital into cash given into the hands of the investor that gives him the right to dispose it in any manner he likes,¹⁶⁶ for example, to spend it or save it or re-invest it by entering into a new *muḍārabah* agreement with the

¹⁶⁴ For example M.N. Siddiqui, *Partnership and profit-sharing in Islamic Law*, Leicester, 1985, p. 35.

¹⁶⁵ *Bidāyah*, Vol. II, p. 308; *Mughnī*, Vol. V, p. 57; *Mabsūf*, Vol. XXII, p. 20; *Kāsānī*, Vol. VI, p. 107; *Minhāj* N., p. 155.

¹⁶⁶ See for example, *Mabsūf*, Vol. XXII, p. 20; *Jazirī*, Vol. III, pp. 61 - 62; *Kāsānī*, Vol. IV, p. 77; *al-Dardir*, *al-Sharḥ al-Saghir*, Vol. II, p. 235.

same party or parties. This is the more practical view from the standpoint of business efficiency and facility of transactions. Furthermore, it leaves no room for a dispute to arise.

Most transactions in the modern age are done with money deposited into banks. The amount of money that exists in a person's bank account is possessed by him exactly as the amount that he has in hand . Based on modern business transactions, if a person enters into a *muḍārabah* contract with a bank, it would be sufficient, as regards concluding the agreement and the distributing of profit, that the original capital be credited to his account. The owner will be able, without withdrawing this money and without taking physical possession of it, to enter a new *muḍārabah* contract with the bank. In our time, it is also possible for him to enter a *sharikah* or *muḍārabah* contract with this money with some other parties and direct the bank, by means of a cheque, to transfer the money to the new business partner.

2.6. Termination of *Muḍārabah* Contract

In the juristic sources, very little attention is paid to the manner in which a *muḍārabah* contract is to be concluded. The *muḍārabah* contract would become dissolved by means of its natural conclusion or at the completion of the venture for which it was undertaken or the expiring of the specified time mentioned in the agreement. In this case, the investor and the agent-manager presumably settle their accounts, divide their profits and happily conclude their association.¹⁶⁷

¹⁶⁷ See Shaybānī, fols. 134b - 135a; *Muw Y.*, p. 455; *M. Muḥtāj*, Vol. II, p. 319; *Mughnī*, Vol. V, p. 64; Kāsānī, Vol. VI, p. 77 & 109; Jazirī, Vol. IV, pp. 872 - 873.

In the case of unsuccessful business, the agent-manager would return to the investor his capital or whatever portion of it was not lost.¹⁶⁸ Beside this, there are a number of occurrences which automatically and instantaneously put an end to a *muḍārabah* contract. Among these are the decision of either party to the agreement to withdraw,¹⁶⁹ death¹⁷⁰ and insanity.¹⁷¹

The majority of the jurists are agreed that a *muḍārabah* contract automatically terminates on the death of either party.¹⁷² The grounds for this termination are that the capacity to own and transact business ends with the death of either party, irrespective of whether the other party is aware of the death or not.¹⁷³ Furthermore, *muḍārabah* contracts entail agency (*wakālah*) and the *wakīl* ends with the death of the investor or agent-manager.¹⁷⁴ Mālikī jurists, however, hold that the death of either party will not automatically terminate a *muḍārabah* contract if it is continued by a competent, honest and sincere heir of the deceased.¹⁷⁵

Right to terminate *muḍārabah* contract

¹⁶⁸ *M. Muḥtāj*, Vol. II, p. 320; *Mughnī*, Vol. V, pp. 66 - 67.

¹⁶⁹ *M. Muḥtāj*, Vol. II, p. 319. *Mughnī*, Vol. V, p. 64.

¹⁷⁰ *Mughnī*, Vol. V, p. 66.

¹⁷¹ *Ibid*, pp. 64 & 66.

¹⁷² *Wajīz*, Vol. I, p. 225; *Mughnī*, Vol. V, pp. 64, 66 - 67; *M. Muḥtāj*, Vol. II, p. 319; al-Dardīr, *al-Sharḥ al-Saghir*, Vol. II, p.136.

¹⁷³ *Kāsānī*, Vol. VI, p. 78.

¹⁷⁴ *Ibid*, p. 172; Wahbah, Vol. IV, pp. 872 - 873.

¹⁷⁵ Al-Sāwī, *Bulghat al-Sālik*, Vol. III, p. 99; see also *Wajīz*, Vol. I, p. 225; Wahbah, Vol. IV, p. 873.

The majority of jurists also agree that in fixed term contracts or even before the work of the agent-manager has actually started, either party has the right to wind up the agreement at any time.¹⁷⁶ Their view is not based on any explicit text in the Qur'ān or in the traditions; it is rather based on the convenience of the parties involved and is meant to secure their freedom of transaction.¹⁷⁷ Nevertheless, the *muḍārabah* contract can be continued as normal in favour of the remaining parties despite the separation of one party in a *muḍārabah* contract involving several parties according to the predetermined conditions.¹⁷⁸

The Mālikī jurists, however, hold the view that completion of business is a necessary condition for the termination of the contract. For example, if the agent-manager is on a journey in order to sell his merchandise, the contract will be terminated only after sale of the goods, as completion of the act of business, and not before it.¹⁷⁹

It seems that the view of the Mālikī jurists who stipulate completion of business as a necessary condition for the termination of contract cannot be agreed. The principle to be upheld is that every party is always free to terminate the contract and this freedom should be restricted only to the degree necessary to avoid prejudice to the interests of other parties.

¹⁷⁶ *Mughnī*, Vol. V, p. 64-65; *Kāsānī*, Vol. VI, pp. 77 & 112; *M. Muḥtāj*, Vol. II, p. 319; *Qinā'*, Vol. II, p. 269; *Fath Q*, Vol. VII, p. 74; *Ḥash. A.*, Vol. IV, p. 510; *Mabsūṭ*, Vol. XXII, p. 19.

¹⁷⁷ See refs. no. 176, above.

¹⁷⁸ 'Alī al-Khafīf, *al-Sharikāt fī al-Fiqh al-Islāmī*, p.140.

¹⁷⁹ Mālik b. Anas, *al-Muwaffa'*, Vol. II, ed. Muḥammad Fu'ād ʿAbd al-Bāqī, Cairo, 1992, p. 532.

Conclusion

As has been discussed in the previous chapter, *sharikah* or partnership may not fall into any one of the specific models mentioned above and may be a combination of all three forms, and *muḍārabah* also may not fall into the classical model. In a real world situation, an investment company may be a combination of *muḍārabah* and *sharikah* where all partners contribute to the capital but not to the entrepreneurship and management. In this form of partnership, profits accrued in the business are not distributed in accordance with capital contributions, but may be shared in any proportion agreed upon by the partners, depending on their contribution to the success and profitability of the business. It seems that the only requirement of the distribution of profits would be justice, which would imply that the proportional shares in profit must reflect the contribution made to the business by the partners' capital, skill, time, management ability, goodwill and contacts. The losses must, however, be borne in proportion to capital contribution and the stipulation of any other proportion would be unenforceable.

2.7. Quasi-Muḍārabah Transactions

This topic will highlight some of the contracts that appear to be semi-*muḍārabah*, i. e. *bay' al-murābahah* and *samsarah* (brokerage) because of the existence in them of some of its features, characteristics and similarities.

2.7.1. Bay^c al-Murābahah¹⁸⁰ (A resale at a specified surcharge or rate of profit, on the stated original cost which represents the profit)

The word *murābahah* is derived from *ribḥ* which means gain, profit or addition.¹⁸¹ Legally, it means a resale of goods or merchandise at a specified surcharge or rate of profit which is mutually agreed upon between the purchaser and the vendor (seller).¹⁸² The payment the of sale price, inclusive of the agreed profit margin, may be immediate or deferred and either in a lump sum or in instalments.¹⁸³ This type of transaction, which was often practised in pre-Islamic times¹⁸⁴ was not mentioned by the Prophet and he did not say whether it was permitted or not. However, some of the Companions initiated a discussion about *bay^c al-murābahah*. Basically partnership between investors and borrowers in profit-sharing re-sales was allowed by the Companions. But ʿAbd Allāh b. Masʿūd held that in this contract, the idea of taking profits by putting a high price on goods in order to cover the cost of

¹⁸⁰ There are four types of *bay^c* that may be described from the point of view of their original cost or price (*raʿs al-mal*). Such classification of *bay^c* includes *bay^c al-musawwamah*, *bay^c al-tawliyah*, *bay^c al-waḍʿah* and *bay^c al-murābahah*. Among them, the most common and popular form of *bay^c* is *bay^c al-musawwamah* which is an ordinary sale and signifies sale for a price which is mutually agreed upon between the vendor and the purchaser without any form of reference to the purchase price. The second is *bay^c al-tawliyah*, i. e., resale at the stated original price (cost) with no profit or loss to the vendor. The third is called *bay^c al-waḍʿah* which means resale at a discount from the original cost. The fourth is *bay^c al-murābahah* or fixed profit sale since the original cost or purchase price is the starting point in this kind of *bay^c*. Jaziri, Vol. II, p. 148.

¹⁸¹ *Lisān*, Vol. II, pp. 442 - 443; *Tāj*, Vol. VI, p. 380; Lane, Vol. I, p.1009.

¹⁸² *Bidayah*, Vol. II, p. 161; *M. Muḥtāj*, Vol. II, p. 77; *Fath Q.*, Vol. VI, pp. 494 and 496; Schacht, *Introduction*, p. 154.

¹⁸³ Nabil A. Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law*. Cambridge, 1986, p.94.

¹⁸⁴ *Mufaṣṣal*, Vol. VII, p. 398.

maintaining them is disliked.¹⁸⁵

Furthermore, the legality of a *murābahah* is not questioned by any of the jurists mentioned in the fiqh literature. In this regard this type of contract is unanimously agreed by them without any rejection.¹⁸⁶ However, the use of *murābahah* transactions as a credit vehicle by the contemporary Islamic financial institutions has been regarded with apprehension by some scholars, for instance, M. N. Siddiqi, who contends that the simple fact that *murābahah* enables a buyer to finance his purchase with deferred payment, as against accepting a mark-up on the market price of the commodities, means that the financier earns a predetermined profit without bearing any risk.¹⁸⁷

It is said that the only factor which, in the opinion of the jurists, might transform *murābahah* into a legal device (*ḥīlah*) used to circumvent the prohibition of taking interest is pricing the time factor. That occurs when, in addition to the initial price of the commodities and other recognized expenses and legitimate profit, an increase is accounted in order to compensate for the delayed payment of the *murābahah* purchase price; otherwise *murābahah* should not, in principle, become suspicious for

¹⁸⁵ *Muṣannaḥ*, Vol. VIII, pp. 231 - 232; *M. Muḥtāj*, Vol. II, p. 77.

¹⁸⁶ *Ṣaḥnūn*, Vol. X, pp. 226 - 241; *Bidāyah*, Vol. II, pp. 161 - 164; *Mughnī*, Vol. VI, p. 199; *M. Muḥtāj*, Vol. II, p. 77; *Hidāyah*, Vol. III, pp. 56 - 57.

¹⁸⁷ Siddiqi, *Issues in Islamic Banking*, Leicester, 1983, pp. 49 and 137ff. See also Muhammad Ayub, "Bay' *Murābahah* As an Islamic Mode of Financing", *Islamic Order*, Vol. VII (2), 1985, pp. 50 - 58.

it is a universally recognized concept under Islamic law.¹⁸⁸

According to Udovitch, it may be speculated that the practice of *bay' al-murābahah* was limited to particular circumstances, for example, a purchaser may have been willing to pay a retailer, who was at hand, a specified surcharge on the cost of certain goods in order to prevent himself from any trouble of buying them from a wholesaler. It may also serve as a form of commission sale, when the purchaser is permitted to obtain commodities on credit and resell them with the surcharge at either a fixed price or a fixed rate of profit based on the original price.¹⁸⁹

(a) Conduct of *murābahah*

The conditions concerning lawful *murābahah* transactions pertain to the commodities, the original price paid by the vendor, any additional costs to compute the total costs serving as the basis of a *murābahah* transaction and the margin of profit charged on the cost as follows.

It is a pre-condition that the cost (price) paid to the vendor must be expressly mentioned prior to the contract. In this regard, the vendor should say : "My capital is so much" or "This commodity has cost me (for example £100.00) and I sell it to

¹⁸⁸ Nabil A. Saleh, *op. cit.*, p. 95.

¹⁸⁹ Udovitch, *Partnership*, pp. 220 - 221.

you for the cost plus a profit (for example £10.00)".¹⁹⁰ The vendor is also required to state the additional expenses incurred on the sale item and he must be just and true to his words. The additional expenses such as transportation, processing and packing charges, etc, that enhance the value of the commodity in any way and that are added as a customary practice of merchants at original price, can be added to the purchase price to form the basis of a *murābaḥah* transaction. It is, however, required that the vendor, in including such additions, should say, "This article has cost me so much".¹⁹¹

It is a pre-requisite that the cost (price) paid to the vendor must be expressed in identical units such as *dirhams* and *dīnārs* or specific articles of weight or measurement. If the original price is an article of which all the units are not similar such as slaves or cattle, the exact price at which the vendor has become owner of the article will remain unknown (*majhūl*). Any goods with unknown price cannot become a basis for *murābaḥah* as it involves the semblance of uncertainty which renders *murābaḥah* sale unlawful.¹⁹²

(b) Expenses in relation to *murābaḥah*

According to Mālīkī law, expenses which can be added to the capital (price) and

¹⁹⁰ Ṣaḥnūn, Vol. XX, p. 179; See also Ibn Rush, Abū al-Walīd Muḥammad b. Aḥmad (d. 520/1126), *Kitāb al-Muqaddimāt al-Mumahhidāt*, (A supplement to *al-Mudawwanah al-Kubrā* of Ṣaḥnūn), Vol. II, Cairo, 1323 A.H., p. 592.

¹⁹¹ *Aṣl*, pp. 155 - 156.

¹⁹² *Hidāyah*, Vol. III, p. 56; *Mabsūṭ*, Vol. XIII, p. 184.

constitute a basis for the calculation of the profit are those which have affected the commodity itself, such as dyeing or tailoring a piece of material.¹⁹³ However, the vendor is not allowed to add expenses to the capital which do not affect the commodity itself and are incurred for services that the *murābaḥah* vendor could not provide personally, such as the cost of transportation or storing the commodity in a warehouse or in storage rented for the purpose mentioned.¹⁹⁴

If the expenses do not affect the commodity itself and are incurred for services that the *murābaḥah* vendor is in a position to render personally, such as a commission paid to broker (*simsār*; *dallāl*) or wages for folding pieces of material, the vendor can neither add nor take into account for the calculation of the profit.¹⁹⁵

The Hanafī jurists have a different approach to this case. According to them, a *murābaḥah* vendor is entitled to add to the capital (price) all expenses accepted normally by the customary practice of the merchants, whether such expenses have affected the commodity itself such as dyeing or tailoring a piece of material or are incurred on account of such commodity such as transporting goods, feeding animals or paying a commission to a broker (*simsār*).¹⁹⁶

¹⁹³ *Muw Y.*, pp. 556 - 557; *Saḥnūn*, Vol. X, p. 226; *Bidāyah*, Vol. II, p.160.

¹⁹⁴ *Saḥnūn*, Vol. XX, p. 226; *Bidāyah*, Vol. II, p. 161; Ibn Rushd (d. 520/1126), *Kitāb al-Muqaddimāt al-Mumahhidāt*, Vol. II, p. 592.

¹⁹⁵ *Bidāyah*, Vol. II, p. 161.

¹⁹⁶ *Fath Q.*, Vol. VI, p. 498; see also *Jaziri*, Vol. II, p. 281.

The Hanbalī jurist, Ibn Qudāmah, holds that all actual expenses incurred as regards the commodity can be added to the original capital (price), provided that the purchaser is made aware of the amount of those expenses and the original price.¹⁹⁷

The Shāfi'ī jurists, in this case, appear to have a similar opinion to the Hanbalīs with the requirement that the fee earned by the vendor or the fee that should have been paid to the third party and is not voluntarily performed, cannot be added to the *murābahah* price unless that is specifically accepted by the purchaser.¹⁹⁸

It is unanimously agreed by the jurists that the margin of profit on the price so reached should be mutually agreed upon between vendor and purchaser.¹⁹⁹ If the contracted goods (merchandise) in a *murābahah transaction* belongs to two investors, the profits will be shared between them in accordance with the different amounts of capital they have invested.²⁰⁰ It is also held that if two investors provide the capital in a *murābahah* transaction, the profits may be divided equally between them provided the parties involved run the business collectively.²⁰¹ However, if the business is run individually, the profits could be divided equally between the parties

¹⁹⁷ *Mughni*, Vol. IV, p. 201.

¹⁹⁸ *M. Muḥtāj*, Vol. II, p. 78; *Jazīrī*, Vol. II, p. 280.

¹⁹⁹ *Saḥnūn*, Vol. XX, p. 227; *Shirāzī*, Vol. I, pp. 401-403; *Mabsūṭ*, Vol. XIII, p. 91; *Bidayah*, Vol. II, p. 161; *Jazīrī*, Vol. II, (Mālikis View), pp. 278 - 280; (Hanafis View), p. 280; (Shāfi'is View), p. 280; (Hanbalis View), pp. 280 - 281.

²⁰⁰ *Saḥnūn*, Vol. XX, p. 235.

²⁰¹ *Muṣannaf*, Vol. VIII, p. 229.

or in accordance with the capital invested by them.²⁰² It is held that if a man buys some goods on credit, and then sells them on the basis of *murābahah*, and the first vendor later discovers this, he (the first vendor) is entitled to claim the profits.²⁰³

The purchaser in a *murābahah* contract has the right of option either to accept or reject the bargain if he wishes in the following circumstances:

- a. He discovers that the vendor has defrauded him by giving false statements concerning the particulars of the goods, the price and additional expenses.²⁰⁴
- b. The vendor himself has bought the commodity on a deferred payment basis and sold it to his customer on prompt payment without informing him.²⁰⁵
- c. A practice on the part of the vendor involves the semblance of an illegal sale.²⁰⁶

(c) Option when a *murābahah* price may be inflated

If purchaser discovers that the *murābahah* price he has paid to the vendor (seller) was unduly inflated, he has the option of either accepting the sale at the stated price or rescinding (*khiyār*) it and taking back his money.²⁰⁷ However, it is

²⁰² *Ibid.*

²⁰³ *Ibid.*, p. 230.

²⁰⁴ *Fath Q*, Vol.VI, p. 500.

²⁰⁵ Al-Shaybānī, *al-Aṣl, Kitāb al-Buyʿ wa al-Salam*, p. 155.

²⁰⁶ *Ibid.*, p. 164; *Fath Q*, Vol. VI, p. 500.

²⁰⁷ Jazīrī, Vol. II, pp. 281 - 282.

held that if the purchaser is no longer in possession of the *murabahah* goods, he will have no option but to confirm the sale.²⁰⁸

Some Hanafī jurists such as Abū Yūsuf hold the view that the purchaser is, in any circumstances, entitled to confirm the *murabahah* contract and claim back the undue increase.²⁰⁹ The Mālīkī view on this case is that the purchaser has the option either of keeping the *murabahah* goods in consideration of its real cost, i. e., the price after devaluation of the undue increase, or of relinquishing the goods to the vendor.²¹⁰ The Shāfi'ī view on this case is that if the *murabahah* goods are still in the *murabahah* purchaser's possession, he is entitled to give them back to the vendor and have money in return or he can keep it and claim the undue increase.²¹¹

If the purchaser in a *murabahah* contract detects fraud after he has used the commodity or it has been destroyed in his hands, he is not entitled to make any deduction from the price on the grounds that the commodity against which he has to practise his right of option (*khiyār*) does not exist.²¹² The other opinion held is that deduction will be made even after destruction of commodity.²¹³

²⁰⁸ *Ibid.*

²⁰⁹ *Fatḥ Q.*, Vol. VI, p. 500; *Jazirī*, Vol. II, pp. 281 - 282.

²¹⁰ *Bidāyah*, Vol. II, p. 162.

²¹¹ *Umm*, Vol. III, p. 93; *Cf. Mughni*, Vol. IV, p. 199.

²¹² This opinion is held by Abū Hanīfah and his disciple al-Shaybānī. See *Mabsūṭ*, Vol. XIII, p. 86.

²¹³ This opinion held by Abū Yūsuf and Ibn Abī Laylā. See *Ibid.*

The main purpose of *murābaḥah* contract (sale) is to protect unskilled general consumers, lacking expertise and skill in various kinds of goods or commodities, from the wiles and stratagems of shrewd businessmen.²¹⁴ In this contract, the purchaser is under the necessity of placing absolute confidence in the word of the seller, who is skilful in the business. Therefore, it is incumbent on the seller to be just and true in his word and to abstain from any fraud or its semblance.²¹⁵ In other words, by basing the sale price on the original cost of the commodities and goods to the vendor (seller), the purchaser is provided with a medium of protection against unfair exploitation by unscrupulous merchants.²¹⁶

2.7.2. *Al-Samsarah* (Brokerage)

A *Simsār* (plural *samāsirah*) is a middle-man or intermediary between a vendor and a purchaser in the execution of a sale,²¹⁷ or a broker who acts as an intermediary between the seller and the purchaser.²¹⁸ He is also known as *dallāl* (commissioned agent),²¹⁹ who like the *simsār* is a man who mediates between the purchaser and the

²¹⁴ *Hidāyah*, Vol. III, p. 56.

²¹⁵ *Kāsānī*, Vol. VI, p. 223.

²¹⁶ Udovitch, *Partnership*, p. 220.

²¹⁷ *Lisān*, Vol. IV, pp. 380 - 381; *Tāj*, Vol. XII, pp. 86 - 87.

²¹⁸ Lane, Vol. I, p. 1426.

²¹⁹ *Ibid.*

vendor (seller).²²⁰ A broker is described either as a *dallāl*²²¹ or *simsār*,²²² and in most cases these words were used in an identical sense.²²³ According to Serjeant, in the tribal areas of some Arab countries like those in Southern Arabia, a *dallāl* is an intermediary between the tribesmen and the shopkeeper. He is an interesting and important figure in the economic life of the country.²²⁴ According to Becker, *dallāl* was the popular Arabic word for a *simsār* or *sinsāl* in pre-Islamic times.²²⁵ It is, however, suggested that *simsār* was Arabicized from Persian,²²⁶ in which (language) it means a well-versed and skilful person.²²⁷

Traders were called *samāsirah* in pre-Islamic times²²⁸ but the Prophet called them

²²⁰ Al-Samʿānī, Abū Saʿd ʿAbd al-Karīm b. Muḥammad b. Maṣṣūr al-Tamīmī, *al-Ansāb*, article "*al-Dallāl*", Vol. V, Hyderabad, 1966, p. 432; al-Jawālīqī, Abū Maṣṣūr Mawḥūb b. Aḥmad b. Muḥammad, *al-Muʿarrab min al-Kalām al-ʿjami ʿalā Hurūf al-Muʿjam*, ed. Aḥmad Muḥammad Shākir, Cairo, 1942, p. 201.

²²¹ Al-Samʿānī, *al-Ansāb*, article "*al-Dallāl*", Vol. V, pp. 430 - 432.

²²² Jawālīqī, *al-Muʿarrab*, p. 201.

²²³ *Ibid.* Al-Dimashqī frequently uses the word *al-simsār* or *samāsirah* in the sense of broker. (See Abū al-Faḍl Jaʿfar b. ʿAlī al-Dimashqī, *Kitāb al-Ishārah ilā Maḥāsini al-Tijārah*, Damascus, 1900, pp. 43 - 44). C. H. Becker, following the author of the *Tāj al-ʿArūs* mentions that the words *dallāl* and *simsār* are identical. (See "*Dallāl*", *El(I)*, Vol. I, 1913, p. 900) It seems that the words were not used as synonymous terms, at least in early Islamic times. Perhaps *al-samāsirah* acquired the meaning of a broker at a later time, as is demonstrated by an earlier usage of the word conveying the sense of a trader. (See Aslam b. Sahl, *Tarikh Wāsiṭ*, edited by G. ʿAwad, Baghdad, 1967, p. 155; also al-Jawālīqī, *al-Muʿarrab*, p. 201).

²²⁴ R. B. Serjeant, "The Quarters of Tarim", *Le Museon*, Vol. LXIII, 1950, p. 278.

²²⁵ "*Dallāl*", *El(I)*, Vol. I, 1913, p. 900; Prof. Schacht mentioned that the term *sensalis* (*sensale*, *sensal*) in Europe was derived from the Arabic word *simsār* (broker). See *Introduction*, p. 78.

²²⁶ *Mufaṣṣal*, Vol. VII, p. 413.

²²⁷ *Tāj*, Vol. III, p. 280.

²²⁸ *Lisān*, Vol. IV, pp. 380 - 381.

tujjār (traders or merchants).²²⁹ In pre-Islamic times, the contract of *samsarah* (brokerage) was commonly practised between townsmen and villagers and was widely practised in all aspects of business transaction.²³⁰ Consequently, this institution played an important role in the economic affairs of the society.²³¹ During the time of the Companions and the Successors, this type of sale was also known as *bayʿ al-qimah* (the sale of real value of goods; the sale of non-fungible goods).²³² This contract applies when an owner of capital says to the broker : "Sell this (commodity) at such and such a price and anything above that is yours".²³³

The concept of an intermediary or middle-man (broker) in commerce is well recognised in Islamic law, though the treatment in the legal manuals is very limited. Most of the scholars quote a tradition on freedom of stipulation in support of the practice. The tradition reads: "Muslims are bound by their stipulations except when they permit the unlawful and prohibit the lawful".²³⁴ They also quote ʿAbd Allāh b. ʿAbbās as saying that there is no objection if a person says, "Sell this garment, for

²²⁹ *Tāj*, Vol. VII, p. 167.

²³⁰ *Mufaṣṣal*, Vol. VII, p. 414.

²³¹ Muhammad Abdul Jabbār Beg, "The Status of 'brokers' in Middle Eastern Society in the pre-modern period", *MW*, Vol. LXVII (2), 1977, p. 87.

²³² *Muṣannaḥ*, Vol. VIII, p. 234.

²³³ *Ibid.*

²³⁴ Ibn ʿArabī, *Sharḥ Ṣaḥīḥ al-Tirmidhi*, "*Abwāb al-Ahkām*", Vol., VI, p. 104; Cf. Abū Dawūd, Vol. III, "*Bāb al-Ṣulḥ*", p. 13; Bukhārī, Vol. III, "*Kitāb al-Ījārah*", p. 262; al-Dārquṭnī, *Sunan*, Vol. III, p. 21 (no. 2869).

whatever exceeds your price".²³⁵ However, he disallowed the broker to buy goods on credit if the owner of the capital had ordered him to buy them in cash.²³⁶ Ibn Sirīn held that if a person says, "Sell (this) for such a price and any profit accruing from it is either yours or to be divided between us", this is allowed.²³⁷

Concerning this contract, there are some jurists such as Ibrāhīm al-Nakha'ī,²³⁸ Ṭāwūs and al-Ḥasan al-Baṣrī,²³⁹ who disapproved of it. It can be suggested that such a contract is disapproved of if it is considered as hiring of service. The person who gave his capital is the hirer and the hirer should specify the amount of hire or service owed to the broker. However, this contract is approved of if it is regarded as contract through the employment of an agent (at the latter's disposal).

The *dallāl* (broker) whose purpose is mediating between the purchaser and the vendor, plays a role similar to that of a commission merchant or agent (*wakīl*). He holds the goods on behalf of the vendor, mediates between vendor and purchaser, and sells for a fee which often takes the form of a commission. The factual description of a *dallāl*'s activities and his rights and duties confirms that he is an agent with the main consequence that the principle is entitled to any sum in excess of the stipulated

²³⁵ Bukhārī, Vol. III, p. 262; See also Sābiq, *Fiqh al-Sunnah*, Vol. III, p. 141.

²³⁶ *Muṣannaf*, Vol. VIII, p.236.

²³⁷ Sābiq, *Fiqh al-Sunnah*, Vol. III, p. 159.

²³⁸ Bukhārī, Vol. III, p. 262; *Muṣannaf*, Vol. VIII, p. 235.

²³⁹ *Muḥallā*, Vol. VIII, p. 429.

price and the *dallāl* is not entitled to anything more than his brokerage fee.²⁴⁰

Muhammad Abd al-Jabbar Beg, in analysing the institution of brokerage states that it is not fully accepted in Islamic law and if accepted will be subject to strict monitoring by the authorities, as it is generally criticised for allowing the broker to make a profit which is incommensurate with his efforts and amounts to *ẓulm* (injustice). These brokerage activities were considered likely to maintain unduly high levels of price for certain commodities which would normally be obtained at a lower price in a market where direct transactions were the rule.²⁴¹ Al-Tha^clabī, an eleventh century writer, followed by a writer of the post-^cAbbāsīd period, criticised the role of the *dallāl* by saying: "Everyone needs capital (in trade) but the capital of a broker is lying".²⁴² The "lying of the broker" (*kādhīb al-dallāl*) was proverbial in medieval ^cIrāq . Al-Dimashqī, a Syrian writer of the twelfth century, described vividly the deceitful practice of the brokers, who did not hesitate to hoax even their next-door neighbours and dear friends.²⁴³

Despite a negative assessment of brokers, their role as intermediaries and middlemen in a broad sense including commercial agency and distribution undoubtedly

²⁴⁰ Samir Saleh, *Commercial Agency and Distributorship in the Middle East*, London, 1989, p. 10.

²⁴¹ M. A. J. Beg, *op. cit.*, pp. 87 - 90.

²⁴² Abū Manṣūr al-Tha^clabī, *Thimār al-Qulūb*, Cairo, 1908, pp. 193 - 194 cited in M. A. J. Beg., *Ibid.*

²⁴³ Al-Dimashqī, *Kitāb al-Ishārah*, p. 95. He wrote : "The broker sometimes described the excellence of the merchandise and had even tricked the expert with it. Sometimes he mentioned the scarcity of the merchandise and its unavailability in the area and some of them have been sold, other than what he had in hand. He also said that price will rise and demand for it is tremendous..."

becomes important in modern commercial and banking activities as well as the local and international market. The role of the market supervisors (*muḥtasib*) as part of the institution of *ḥisbah* was seen to an effective way of controlling the practice.²⁴⁴ The government would have to intensify the enforcement of the commercial law, for example implementing a price control policy (*tasʿīr*). Furthermore, the formation of guilds of brokers can also stand surety for the smooth and honest operation of its members.

²⁴⁴ Abū al-Faraj b. ʿAlī b. al-Jawzī, *al-Muntaẓam fī Tarīkh al-Mulūk wa al-Umam*, Vol. X, Hyderabad, 1938 - 1939, p. 223; Claude Cahen and M. Talbi, "*Ḥisbah*", *EI*(2), Vol. III, 1971, pp. 485 - 488; see also R.B Serjeant, "A Zaidi Manual of *Ḥisbah* of the 3rd century (H)", *Rivista Delgi Studi Orientali*, Vol. XXVIII, 1953, pp. 1 - 34; J. Derek Latham, "Translation of al-Jarsifi's treatise on '*Ḥisba*', *Journal of Semitic Studies*, Vol. V, 1960, pp. 124 - 143; Benjamin R. Foster, "Agoranomos and *Muḥtasib*", *JESHO*, Vol. XIII, 1970, pp. 139 - 144.

PART TWO

PARTNERSHIP IN ISLAMIC BANKING AND FINANCE IN MALAYSIA

CHAPTER THREE

PARTNERSHIP IN THE OPERATION OF ISLAMIC BANKING OF MALAYSIA

CHAPTER THREE : PARTNERSHIP IN THE OPERATION OF ISLAMIC BANKING OF MALAYSIA

Introduction

In this chapter we shall discuss the emergence of the modern Islamic banks, how banking could be established on the basis of joint stock company which operates on the basis of the contracts of partnership, i. e. *muḍārabah* and *mushāarakah*, the modes of operations of Islamic banking, the establishment and operations of *Bank Islam Malaysia Berhad*¹ and the application of partnership (*muḍārabah* and *mushāarakah*) in the operations of *BIMB*.

3.1. The Emergence of Islamic Banks

The emergence of modern Islamic banks² can be seen as having four distinct phases:

- a. The experimental domestic phase
- b. The international phase
- c. The phase of dissemination
- d. The phase from 1980 until 1985.

¹ Hereafter referred to as *BIMB*.

² At least since the late 1940s, there have been academic and theoretical discussions in the Muslim world, especially in Pakistan, on interest-free Islamic banking. The goal was the design of a bank which offers to its customers the whole variety of financial services of conventional commercial banks but on an interest-free basis, i. e. the goal was the design of an interest-free Islamic commercial bank. See for example, Anwar Iqbal Qureshi, *Islam and the Theory of Interest*, Lahore, Pakistan, 1967; Sh. Mahmud Ahmad, *Economics of Islam : A Comparative Study*, New Delhi, 1980 and Muhammad Uzair's *An Outline of Interestless Banking* published by Raihan Publications, Karachi, 1955, 21p; M. N. Siddiqi, *Muslim Economic Thinking : A Survey of Contemporary Literature*, Leicester, U. K., 1981, pp. 219 - 220; Volker Nienhaus, "Islamic Banks-A Short Survey" in *Islam and the Modern Age*, Vol. XIV (1), 1983, p. 1.

(a) The experimental domestic phase

A pioneering experiment in putting the principles of Islamic banking into practice was conducted in rural Egypt in Mit Ghamr and Dondait, about 40 miles north of Cairo in 1963.³ The experiment combined the idea of German Saving Banks with the principles of rural banking.⁴ The main objective of this experiment was to start rural banks in order to stimulate the habit of savings among small savers (village communities) with the view to accelerating the process of capital accumulation and economic growth.⁵ The bank had started in a modest way with one room and a staff of twenty-five persons. The rural people in that region were religious and would not put their savings into any bank because of interest being forbidden in Islam. Moreover, there was hardly any institution available to them. Under these circumstances, the emphasis was given to educating people about the use of banking.⁶

These rural banks operated three types of accounts:

1. Savings accounts
2. Investment accounts

³ R. K. Ready, "The Egyptian Municipal Saving Bank Project", *International Development Review*, Vol. IX(3), 1967, pp. 2-5; See also, Delwin A. Roy, "Islamic Banking", *Middle Eastern Studies*, Vol. XXVII (3), 1991, p.428;

⁴ T. Wholers-Scharf, *Arab and Islamic Banks : New Business Partners for Developing Countries*, Paris, 1983, pp. 79-80.

⁵ Aḥmad al-Najjār, *al-Madkhal ilā al-Naẓariyyah al-Iqtisādiyyah fī al-Manhaj al-Islāmī*, Dār al-Fikr, 1973, pp. 26-27; *Idem*, "Islamic banks : A Model and the Challenge" in Altaf Gauhar (ed.), *The Challenge of Islam*, London, 1978, p. 222; Delwin A. Roy (1991), *op. cit.*, p.428.

⁶ R.K. Ready (1967), *op. cit.*, p.2-5; T. Wholers-Scharf (1983), *op. cit.*, pp. 79-80; Aḥmad al-Najjār, "Islamic Bank : A New Approach for Economic Cooperation" in Muazzam Ali (ed.), *Islamic Bank and Strategies for Economic Cooperation*, International Association of Islamic Bank, 1982, pp. 26-28.

3. Social service fund or zakat accounts.⁷

In a saving account, depositors could start saving with a minimum deposit of five piasters (about 5 pence). No interest was due on these accounts, but depositors were entitled to a small short-term interest-free loan (*qard ḥasan*) for productive ventures and the bank would also help them in terms of technical assistance without any payment.⁸

The investment accounts drew deposits, but unlike savings accounts, restricted withdrawals. These funds were invested on a profit and loss sharing basis, either directly by the bank to finance their rural projects or through the agency of local entrepreneurs who were in need of funds.⁹ The yield of these investments was distributed among depositors in this fund in proportion to the amount and duration of their deposits. Freedom to draw from the sum deposited in this account is restricted in accordance with the nature of the investment operations and liquidity requirements.¹⁰

The resources in the social service fund were amassed from the money provided and from public bodies. They were distributed in the form of financial assistance to

⁷ R. K. Ready, "The Egyptian Municipal Savings Banks Project", *International Development Review*, Vol. IX (2), 1967, p. 3; al-Najjar (1982), *op.cit.*, pp. 26-27; *Idem*, *Bunūk bilā Fawā'id*, Jeddah, 1972, pp. 51-53; *Idem*, "Local Social Banks", in *Al-Islam*, Vol. IV (2), (Singapore, 1973), pp. 1 - 4; Shahrukh Rafi Khan, *Profit and loss Sharing : An Islamic Experiment in Finance and Banking*, Karachi, 1987, p. 53.

⁸ Ready (1967), *op. cit.*, pp. 3 - 4; Aḥmad al-Najjār (1978), *op. cit.*, p. 225; Delwin A. Roy (1991), *op cit.*, p. 428.

⁹ Aḥmad al-Najjār (1982), *op. cit.*, p. 27.

¹⁰ Ready (1967), *op. cit.*, pp. 3 - 4; Aḥmad al-Najjār (1978), *op. cit.*, pp. 224-225.

savers who were in financial difficulties as a result of unforeseen misfortune.¹¹

Table 1 reviews the progress of the Egyptian experiment over a three year period.¹²

Table 1

Operation of the first Islamic Bank in Egypt over a three year period (Egyptian £'s)

	1963	1966
Savings Accounts	25,000	125,000
Investment Deposits	35,000	75,000
Investment Financed		30,000

Source : R. K. Ready, "The Egyptian Municipal Savings Bank Projects" in *International Development Review*, Vol. IX (2), 1967, p. 4.

The growth reflected in the numbers above is impressive, especially since the project began with one room and a small staff. The experiment met unexpected success as savings deposits increased from 25,000 Egyptian pounds to 125,000 Egyptian pounds during 1963-1966. During the same period, investment deposits increased from 35,000 Egyptian pounds to 75,000 Egyptian pounds.¹³ It is also reported that "the bank functioned on a cautious basis, rejecting on average, 60 per cent of loan applications in the first three years. The default ratio was zero in economically good times".¹⁴

¹¹ *Ibid.*, p. 225; *Idem*, "Local Social Bank", *op cit.*, p. 2.

¹² R. K. Ready, *op. cit.*, p. 4; see also Shahrukh Rafi Khan, *op. cit.*, p.54.

¹³ R.K. Ready, *op. cit.*, p. 4.

¹⁴ Shahrukh Rafi Khan, *op. cit.*, p. 54.

The success of the experiment in part resulted from the direct participation of the local community. Thus, because transactions were based on intimate contact and mutual trust and because the interest of the community was directly at stake in the transactions, a fair amount of social pressure was present as a check on the borrowers. Demand also mushroomed from neighbouring communities, which appreciated the ethical and decentralized approach of the bank. In 1967, four more branches were added to the initial bank, and eight new banks were opened. After three years of its operations, there were sixty thousand depositors, and when the operations had to be stopped due to certain political factors, there were close on a million.¹⁵

Egypt was also responsible for the first successful urban-based experiment in the form of an Islamic welfare oriented bank, called The Nasser Social Bank. It was established in September 1971 and started its operation in 1972 and is still in existence. The bank is a public authority with an autonomous status. Its main objectives are social services such as granting interest-free loans for small projects on a profit sharing basis, assistance to the poor and needy, and loans to needy students for higher education.¹⁶

¹⁵ *Ibid.*, p. 54; Aḥmad al-Najjār (1978), *op. cit.*, pp. 230-232; Cf. Asif Huda, "The New Islamic Bankers", *Middle East*, No. 89, March, 1982, p. 68.

¹⁶ Information on the Nasser Social Bank is drawn from a report edited by The Banker Research Unit entitled *Banking Structures and Sources of Finance in the Middle East*, London, 1980, pp. 178-180; Cf. Shahrukh Rafi Khan, *op. cit.*, pp. 54-55; Ausaf Ahmad, *Development and Problems of Islamic Banks*, Jeddah, 1987, p.4; Delwin A. Roy (1991), *op. cit.*, p. 428.

(b) The international phase

The international phase of Islamic banking started in August 1974, when the draft agreement of the Islamic Development Bank was adopted by the Islamic Conference of Ministers of Finance. The agreement had far-reaching implications. It was considered the first official document reflecting the Islamic point of view regarding the modern banking system. It also reflected a new phase featuring the practical potential of Islam with its spiritual, moral and intellectual reserves in the field of modern banking systems and economic thought. It was unequivocal in its adherence to the provisions of the *Shari'ah*, saying that the Islamic Development Bank was to support the economic development and social progress of Islamic communities in accordance with the provisions of Islamic law. It also represented in a practical way the image of unity of the Muslim *ummah* concerning the establishment of the Bank. It was also an official proclamation by all the Muslim states that there existed a distinct Islamic system of economy.¹⁷

The late King Faisal of Saudi Arabia and various international Islamic organisations such as the Muslim World League, had campaigned for the establishment of an international Islamic financial institution to foster economic and social progress in Muslim countries. This led to the establishment of the Islamic Development Bank (IDB) in 1975 with an authorised capital of 2 billion dinars (about \$ 1.25 million) and with its headquarters in Jeddah, Saudi Arabia.¹⁸ The Bank

¹⁷ Muazzam Ali, "A Framework of Islamic Banking", in *Directory of Islamic Financial Institutions* edited by John R. Presley, Kent, 1988, pp. 4 - 6; Hj. Azlan Khalili Hj. Shamsuddin, *Banking and Finance in Islam*, Kuala Lumpur, Malaysia, 1988, p. 24.

¹⁸ Waqar Masood Khan, *Towards an Interest-Free Islamic Economic System*, Leicester, U.K., 1985, P. 91.

has grown from twenty-two member countries to forty-three after ten years of operation. It aims at promoting the harmonious and balanced development of member countries through mutual financing and economic co-operation. It encourages trade and transfer of technology among member countries, provides technical assistance, and funds research. The cornerstone of its policy is stated to be the replacement of interest by co-operation in all international dealings on the basis of profit and loss sharing. Accepting deposits from individuals and the government, it disburses funds for productive projects on the basis of either direct interest-free loans, equity financing, or profit and loss sharing. The Islamic Development Bank found a shortage of trained manpower to be one of the main bottlenecks retarding the progress of its operations. Therefore, it started the Islamic Research and Training Institute (IRTI) in 1981.¹⁹

In the sixth year of its operation, the Islamic Development Bank had participated in more than 275 projects in thirty-six countries by financing development projects with interest-free loans. The Bank's sixth annual report puts the amount it has committed to development projects, trade financing, technical assistance (which mainly finances feasibility studies) and the special assistance account for the poorer countries at \$2.18 billion of which 66.7 per cent has actually been disbursed.²⁰

¹⁹ W. E. Kuhn, "The Islamic Development Bank : Performance and Prospects", *Journal of Economics and Business*, Vol. XXI, (Nebraska, 1982), pp. 49 - 63; Mannan, article "Islamic Bank in Operation : Treads and Issues" in *The Making of Islamic Economic Society*, Cairo, 1984, pp. 453 - 470; *Idem*, " The Islamic Development Bank and Economic Development of Southeast Asia", in Mohamed Ariff (ed.), *Islamic Banking in Southeast Asia*, Singapore, 1988, pp. 172 -185; Muazzam Ali (1988), *op cit.*, pp. 5 - 6; R. Wilson, "The Islamic Development Bank's Role as an Aid Agency for Moslem Countries", *Journal of International Development*, Vol. III, 1989, pp. 444 - 466; Shahrukh Rafi Khan, *op. cit.*, pp. 55-56.

²⁰ Waqar Masood Khan, *op. cit.*, p. 91.

(c) The phase of dissemination

The phase of dissemination was between 1975 and 1979. During this period, a number of Islamic financial institutions opened for business. It started with the establishment of the Dubai Islamic Bank in 1975.²¹ In 1976, Jaame in Johannesburg was set up with an estimated 1981 turnover of \$250,000. In 1977, more high-powered companies like the Faisal Islamic Bank of Sudan (FIBS) and the Islamic Investment Company (IIC) registered in the Bahamas but bases in Geneva were established. The International Association of Islamic Banks was also established in 1977 to promote co-operation among Islamic banks and to co-ordinate their activities. In 1978, the Faisal Islamic Bank of Egypt, the Islamic Bank of Jordan and Islamic Banking of Luxembourg were established. These were followed in 1979 by the Bahrain Islamic Bank, the Kuwait Finance House, the Jordan Islamic Bank for Investment and Finance, and Iran Islamic Bank.²²

(d) The phase from 1980 until 1985

This phase can be marked from the announcement of President Zia-ul-Haq of Pakistan on 10th February 1979 of his intention to remove interest from the economy

²¹ The success of the rural bank in Egypt's experiments encouraged the Dubai Merchants to utilize the new forms of banking to harness the wealth of those in the Emirates who on religious grounds refused to have dealing with the conventional banks. See Delvin A. Roy (1991), *op. cit.*, pp. 429 - 450.

²² Rodney Wilson, *Banking and Finance in The Arab Middle East*, London, 1983, p. 80; Muhammad Nejatullah Siddiqi, "Islamic Banking : Theory and Practice", in Mohamed Ariff (ed.), *Islamic Banking in Southeast Asia*, Singapore, 1988, pp. 42 - 45; Waqar Masood Khan, *op. cit.*, p. 91; Delvin A. Roy (1991), *op. cit.*, pp. 429 - 450.

within a period of three years.²³ At the end of 1979, there were twelve Islamic banks.²⁴ More Islamic banks were established between 1980 and 1985, so that their number reached over fifty excluding Islamic Banks in Pakistan and Iran.²⁵ The establishment of Dār al-Māl al-Islāmī based in Geneva (DMI) on 26th Ramadan 1401 H. corresponding to July 27th 1981, which now has twenty-two subsidiaries, and the al-Baraka Group,²⁶ based in Jeddah, Saudi Arabia to which nine institutions belong, has introduced a new phase of integrated multinational institutions in the Islamic finance movement.

Dār al-Māl al-Islāmī (DMI) was established as a trust and a holding company with an authorized capital of US 1 billion for the purpose of promoting a diversity of financial business in accordance with Islamic law through the establishment of a network of Islamic investment companies, Islamic banks, insurance (*takāful*) companies and Islamic business institutions. Dār al-Māl al-Islāmī and its subsidiaries engage in four types of transactions, *muḍārabah*, *mushārahah*, *murābahah*, leasing,

²³ Ziauddin Ahmed, "Interest-Free Banking in Pakistan" in *JIBF*, Vol. IV (1), 1987, p. 14; Mohammad Anwar, *Modelling Interest-Free economy : A Study on Macroeconomics and Development*, Herndon, U. S. A., 1987, pp. 10 - 11.

²⁴ This includes the Malaysian Pilgrims Management and Fund Board in Malaysia.

²⁵ *Encyclopaedia of Islamic Banking and Insurance*, London, 1995, pp. 301 - 386.

²⁶ Al-Baraka Group and its nine affiliates (institutions) were established in 1982 with an authorized capital of \$5 billion US dollars. Besides *murābahah*, *mushārahah*, *muḍārabah* and leasing, *bayʿ al-salam* is also mentioned as one of the activities planned. *Murābahah* has accounted for the bulk of the business so far, but some efforts are being made to use various profit-sharing modes of finance as well. The bank and companies of the al-Baraka Group have set out a number of strategic objectives. These include a comprehensive and integrated plan of work which aims at the ideal utilization of human and juridical Islamic capabilities and resources in order to participate creatively in the socio-economic system with its economic, financial and investment rules and regulations. See Saleh Abdullah Kamel, "Islamic Banking in Practice : The al-Baraka Group In Muslim Minority Countries", in *JIMMA*, Vol. XIII (2), 1992, pp. 325 - 336; See also Muhammad Nejatullah Siddiqi (1988), *op. cit.*, p. 45.

and some interest-free loans with a view to promoting Islamic banking.²⁷

(e) Islamic banking at the national level²⁸

In the fourth phase, Islamic banking has also been adopted at the national level, as in Pakistan,²⁹ Iran³⁰ and Sudan.³¹ These countries have the largest number of Islamic financial institutions of any country.

3.2. Theory of Islamic Banking

3.2.1. The Establishment of an Islamic Bank: A Simple Model

An Islamic bank would be organized as a joint stock company with the shareholders supplying the initial capital (share capital).³² It is managed by the

²⁷ *Ibid.*, pp. 44-45.

²⁸ Mohammad Anwar, *op cit.*, p. 10.

²⁹ Muhammad Akram Khan, "Islamic Banking In Pakistan", in *International Journal of Islamic and Arabic Studies*, Vol. II (2), 1985, pp. 21 - 35; Christine Gieraths, "Pakistan : Main Participations and Final Financial Products of the Islamization Process" in Rodney Wilson (ed.), *Islamic Financial Markets*, London and New York, 1990, pp. 171 - 195.

³⁰ Hossein Aryan, "Iran : The Impact of Islamization on the Financial System", in Rodney Wilson (ed.), *Islamic Financial Markets*, pp. 155 - 170; Article, "Monetary Resources and Banking Facilities under the Law for Usury-Free Banking" in *al-Tawhid*, Vol. III (4), 1986, pp. 60 - 77 and article, "The Impact of the New Banking System in Iran on the Instruments of Monetary and Credit Policy", pp. 78 - 89; Muhsin Nurbakhsh, "The Inroduction of Usury-Free Banking in Iran", *al-Tawhid*, Vol. IV (4), 1986-87, pp. 89 - 96.

³¹ For example, see al-Bagkir Y. Mudawi, "Islamic Banking : Evaluation of Sudanese Experience" in *JIBF*, Vol. I (1), 1984, pp. 51 -57.

³² M. N. Siddiqi, *Banking Without Interest*, Leicester, U. K., 1988, pp. 15 - 18; See also Ausaf Ahmad, *Development and Problems of Islamic Banks*, p. 14 - 15; M. A. Khan, *Issues in Islamic Economics*, Lahore, 1983, p. 50.

shareholders through their representatives on the board of directors. Its main business is to obtain funds from the public on the basis of *muḍārabah* and with these capitals some enterprises may be financed and services rendered for earning profit and receiving remuneration, on the basis of partnership and *muḍārabah*.³³ This form of joint investment is called *‘inān* partnership, where two or more persons would participate in an enterprise with a fixed amount of capital under an agreement that they will work jointly and will participate in the profit or loss of the business proportionately,³⁴ as has been explained earlier.³⁵ In this case, it is not necessary that every partner should participate in running the business. Practically, although none of the partners can be prevented from such participation, in principle, they shall have the right even though they may or may not participate practically.³⁶

The amount of capital provided by each shareholder may be equal or vary. It may, however, be an ideal proposition to fix the value of one share at any given price and every shareholder may be allowed to secure as many as he likes. The minimum and maximum limits of the subscribed capital may also be specified. Each shareholder would become the owner of the bank, according to the proportion of his assets in the total investment.³⁷

³³ M. A. Mannan, "Islam and Trends in Modern Banking" in *al-Islam*, Vol. III (3), (Singapore, 1972), p. 3; Mohsin S. Khan and Abbas Mirakhor, "The Framework and Practice of Islamic Banking", in *Finance and Development*, September 1986, p. 33; Cf. Abu Saud, "Money, Interest and *Qirād*", in K. Ahmad (ed.), *Studies in Islamic Economics*, Leicester, 1981, pp. 59 - 84.

³⁴ Siddiqi, *Banking Without Interest*, p. 15; M. Muslehuddin, "Comments Upon the Egyptian Study on the Establishment of the Islamic Banking System", *al-Islam*, (Singapore, June 1973), pp. 37 - 38.

³⁵ See Chapter I, 1.3.2 (a), (b), (c) and (d) pp. 67 - 78.

³⁶ M. N. Siddiqi (1988), *op. cit.*, p. 15; Cf. Abdelmoneim Mahmoud el-Gousi, *Riba Islamic Law and Interest*, Unpublished Ph. D Thesis, Temple University, 1982, pp. 225 -229.

³⁷ Siddiqi (1988), *op. cit.*, p. 15.

As regards the volume of profits in the banking business, it would be appropriate to adopt the policy of proportionally distributing them according to the size of each individual's capital (number of shares), and, for this purpose, the total investment of the bank may be divided by the total profit, in order to determine the percentage of profit payable to each individual shareholder. There is, however, every justification for the adoption of a formula of even the disproportionate distribution of the profit, more so because some of the members would be more competent and active than others to play a more effective role in the promotion of business and may be willing to undertake more responsibilities in this direction. In the light of the partnership principles in Islam, if the bank suffers a loss in any year, the shareholders cannot escape the liability, and have to share the loss in proportion to the size of their shares.³⁸

All major decisions regarding the overall operation of the bank would be made with the mutual understanding of the partners. If, however, the partners are very large in number, the powers to make decisions on various matters (which should be determined beforehand) would be delegated to a council of representatives. Day-to-day decisions on routine business matters would be entrusted to the paid managers whose appointment and removal would rest in the hands of the partners of the council of representatives.³⁹

³⁸ *Ibid.*, p. 16; S. M. Hasanuzzaman, "Limited Liability of Shareholders : An Islamic Perspective", *IS*, Vol. XXVIII (4), 1989, pp. 353 - 361; *Idem*, "The Liability of Partners in an Islamic Shirkah", *IS*, Vol. x (4), 1971, pp. 319 - 341; M. Raquibuz Zaman, "Monetary and Fiscal Policies of an Islamic State : The Claims Versus the Reality", *International Journal of Islamic and Arabic Studies*, Vol. V (1), 1988, pp. 23 - 24.

³⁹ Siddiqi (1988), *op. cit.*, p. 16.

3.2.2. Principles of *Mudārabah* and *Mushārah*

It is reported that the operations of Islamic banking and financial institutions should be on the basis of profit and loss-sharing in consonance with the Islamic legal concept of *sharikah* and *mudārabah*, and also *qard ḥasan*.⁴⁰ *Qard ḥasan* is a loan extended without any additional charge over and above the principal amount.⁴¹ Under this system, the amount of return on the funds invested is neither fixed nor pre-determined. The ratio of profit depends on the operational results of the economic undertaking. When capital is provided entirely by one party and enterprise or labour entirely by another party, the proportion of profit are to be agreed proportionately at the time of the contract, while loss is to be borne by the supplier (provider) of the capital unless it is due to the negligence of the entrepreneur (worker). If there is more than one supplier of capital, profit is to be distributed among them in agreed proportions, while loss is to be shared by them strictly in proportion to their capital contributions.⁴²

⁴⁰ For a discussion see Ingo Karsten, "Islam and Financial Intermediation", in *IMF Staff Papers*, Vol. XXIX (1), March 1982, pp. 108 - 142 and the *CII Report* which contains a detailed blueprint for reorganisation of the operations of Islamic banking and finance entitled "Elimination of Interest from the Economy" in Ziauddin Ahmed, et al (eds.), *Money and Banking in Islam*, Islamabad, 1983, pp. 103 - 257; M. U. Chapra, *Towards a Just Monetary System*, Leicester, 1985, pp. 166 - 173.

⁴¹ *Al-Mawsū'ah al-ʿIlmiyyah wa al-ʿAmaliyyah Li al-Bunuk al-Islamiyyah*, Vol. V, Cairo, n. d., pp. 206-211; Cf. Nabil A. Salleh, *Unlawful Gain and Legitimate Profit in Islamic Law*, Cambridge University Press, 1986, pp. 99-100.

⁴² See M. Mohsin, "A Profile of Riba-Free Banking" in Mohamed Ariff (ed.), *Monetary and Fiscal Economics of Islam*, Jeddah, 1982, pp.188; Mohamed Ariff, "Introduction" in *Ibid*, pp. 6 - 9; Muhammad Abdul Mannan, "Allocative Efficiency, Decision and Welfare Criteria In An Interest-Free Islamic Economy", in *Ibid*, pp. 53 - 62; AbulHasan Muhammad Sadeq, "Economic Growth in an Islamic Economic" in AbulHasan Muhammad Sadeq, et al (eds.), *Development and Finance In Islam*, Petaling Jaya, Malaysia, 1991, pp. 60 - 61; M. Umer Chapra, "Towards An Islamic Financial System", in AbulHasan Muhammad Sadeq, et al (eds.) (1991), *Ibid*, pp. 130 - 137; *Idem*, "Money and Banking in an Islamic Economy", in Mohamed Ariff (ed.), *Islamic Banking in Southeast Asia*, pp. 51-57; Munawar Iqbal and M. Fahim Khan, *A Survey of Issues and a Programme for Research in Monetary and Fiscal Economics of Islam*, Jeddah and Islamabad, 1981, pp. 75 - 76; Zubair Hasan, "Distributional Equity in Islam" in Munawar Iqbal (ed.), *Distributive Justice and Need Fulfilment in an Islamic Economy*, Leicester and

It may be mentioned that in the case of Islamic Banking, there will be three parties involved, i. e.:

- a. The actual user of the capital or entrepreneur;
- b. The bank which serves as a partial user of capital funds and as an intermediary link, and
- c. The supplier of savings or capital funds, i.e. the depositors in the bank.⁴³

There are two *muḍārabah* contracts involved between the actual entrepreneurs, the bank and the depositors. One tier of *muḍārabah* contract is between the bank and the depositors. In this contract, the depositors are the owners of the wealth (*aṣḥāb al-māl*) and the bank becomes the entrepreneur. The second tier of *muḍārabah* contract is between the bank and the actual user of the fund or the entrepreneurs. In the second contract, the bank will become the owner of the wealth (*ṣāḥib al-māl*) which will share the profits with the entrepreneurs.⁴⁴

Islamabad, 1986, pp. 45 - 59; Syed Aftab Ali, "Risk-Bearing and Profit-Sharing in an Islamic Framework : Some Allocational Considerations", in Ziauddin Ahmed , et al (eds.), *Fiscal Policy And Resource Allocation in Islam*, Jeddah and Islamabad, 1983, pp. 253 - 269; Masudul Alam Chowdhury , "A Mathematical Formulation of The principle of 'Mudarabah', The Profit-Sharing System", in *Proceeding of the Third National Seminar of the Association of Muslim Social Scientists*, Gary, Indiana, 1974, pp. 45 - 49; Azlan Khalili Shamsuddin, *Banking and Public Finance in Islam*, pp. 31 - 32; Ma'bid Ali al-Jarhi, "A Monetary and Financial Structure for an Interest-Free Economy : Institutions, Mechanism and Policy" in Ziauddin Ahmed, et al (eds., *Money and Banking in Islam*, pp. 70 - 90, see also "Introduction" by the editors, pp. 8 - 14.

⁴³ See for example, Muhammad Uzair, "Some Conceptual and Practical Aspects of Interest-Free Banking", in Khurshid Ahmad (ed.), *Studies in Islamic Economics*, Leicester, 1980/1400 H., p. 46. Hereafter referred to as *Some Conceptual and Practical Aspects of Interest- Free Banking*; See also Anu N. M. Wahid, "Islamic Banks and a Theory of Optimal Profit Sharing", in *IS*, Vol. XXIV (3), 1985, pp. 389 - 396; Mohammad Mohsin, "Feasibility of Commercial Banking Without Rate of Interest and Its Socio-Economic Significance", *IQ*, Vol. XX-XXII (4), 1978, pp. 152 - 155.

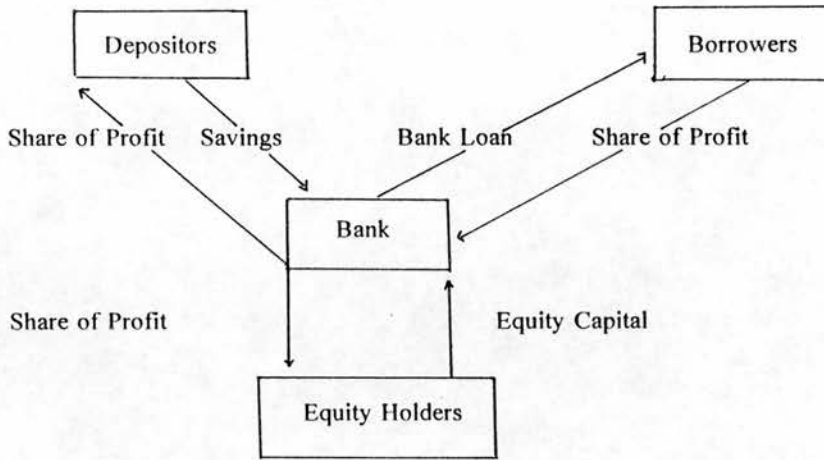
⁴⁴ Uzair, *Some Conceptual and Practical Aspects of Interest-Free Banking*, pp. 46-47; There may be, for example, an arrangement that the entrepreneur (or the borrower in the present-day banking system) and the bank would share the profit in a ratio of 50 per cent each, or 60 per cent for the entrepreneur and 40 per cent for the bank, or any such ratio as may be agreed upon between themselves. Similarly, there will be

In this triangular relationship depositors-bank-entrepreneurs as shown in Figure 3.1 below, the bank will have direct contact with both the depositors and the entrepreneurs. The bank accepts deposits into "investment accounts" entitled to an agreed percentage share of the profits accruing to the bank on the profitable employment of these deposits in a pooled manner. These depositors are liable to losses, their liability being limited to the extent of their deposits. As a financial intermediary mobilising savings from the public, the bank will invest their funds (share capital, *muḍārabah* deposits and part of the demand deposits) in a variety of forms of investments including partnership contracts with other investors or *muḍārabah* contracts with entrepreneurs. The bank and investors are entitled to an agreed percentage share of the profits accruing to these funds in the business enterprise. These *muḍārabah* funds invested in the business are also liable to losses which are limited to the extent of the funds supplied. The bank and its shareholders will share the profit and loss in the enterprise, i. e. the bank after sharing the profit and loss with the entrepreneurs on the mutually agreed terms, will share its income with the depositors according to the predetermined percentage.⁴⁵

an arrangement between the bank and the supplier of capital (or depositors in the present-day banking system) for sharing the profit in the ratio of 50 per cent each or 60 per cent for the bank and 40 per cent for the suppliers of capital funds or the depositors.

⁴⁵ Waqar Masood Khan, *op. cit.*, p. 74; M. N. Siddiqi, *Banking Without Interest*, pp. 21 -37; *Idem*, *Issues In Islamic Banking*, pp. 22 - 24, 59 -61, 97 -113, pp. 134 - 136; *Idem*, "Economics of Profit-Sharing", in Ziauddin Ahmad, et al (eds.), *Fiscal Policy and Resource Allocation in Islam*, Leicester, and Islamabad, 1983, pp. 163 -177; Abu N. M. Wahid, "A Theoretical Justification of Islamic Banks", *IQ*, Vol. XXX(3), 1986, pp. 193 - 194; Timur Kuran, "The Economic System in Contemporary Islamic Thought : Interpretation and Assesment", *IJMES*, Vol. XVIII, 1986, pp. 149 - 152; Zubair Iqbal, "Theory of Profit : The Islamic Viewpoint", *JRIE*, Vol. I (1), 1983, pp. 12 - 15; Zaidi Sattar, "A Dynamic Investment Model with Profit-Sharing in an Interest-free Economy : Methodological Issues", *AJISS*, Vol. VIII (1), 1991, pp. 110 - 113.

Figure 3.1



Another way of profit and loss sharing in the context of Islamic banking is *mushārah* (partnership). In distinction to *mudārah*, the two partners in *mushārah* participate in the capital of the venture. Profits are allocated according to the agreed proportion. If losses occur, they are borne by the partners in proportion to their contribution of the capital. For example, the bank may participate in 60 per cent of the capital though its share in profits might not exceed 50 per cent, whilst, in the case of losses, the bank's liability must not be less than 60 per cent.

A number of other alternative financing arrangements within the general framework of Islamic values have been suggested in the literature of Islamic banking. The major alternatives recommended are : *ijārah* (leasing), hire-purchase, *bay' bithaman ājil* or *bay' mu'ajjal* (a sale against deferred payment), *murābahah* and *bay' al-salam*.⁴⁶ In all other instances these scholars advise against employment of these methods, warning that the banking system may come to rely too heavily on weakly Islamic modes such as *murābahah*, which, because of their simplicity, minimal risk

⁴⁶ CII Reports, p. 110.

and predetermined fixed rate of return, preserve the status quo associated with traditional banking, with its emphasis on the creditworthiness of the client and the maintenance of credit-debtor relationship.⁴⁷

The general principle, which is beyond dispute as being the criterion for determining the permissibility or otherwise of any method of financing, is that the financier cannot avert the taking of risk if he wishes to derive an income.⁴⁸ However, these alternative techniques would be of importance in financing small businesses that are unable to maintain proper accounts and hence may not be conducive to

⁴⁷ The Council of Islamic Ideology of Pakistan gave due recognition to the difficulties that may arise in changing the whole system to profit sharing in one step, and, therefore, gave qualified approval to the above-mentioned other methods being used in conjunction with profit and loss sharing (*muḍārabah* and *mushārah*). *CII Report*, p. 110; For a discussion see M. U. Chapra, *Towards a Just Monetary System*, pp. 166 - 173. Dr. Ziauddin Ahmed makes the following observation about these techniques: "Though far simpler to operate compared to profit/sharing, (they) cannot be recommended for widespread use as they cannot be of any material assistance in achieving the socio-economic objectives of an Islamic economy. The fact that replacement of interest by *bay' mu'ajjal* (mark-up), for example, does not represent any substantive change becomes apparent if one views it in the perspective of the philosophy behind the prohibition of interest. As mentioned earlier, the interest system is disallowed in Islam because intrinsically it is a highly inequitable system. The feature that makes the interest system inequitable is that the provider of funds is assured a fixed return while all the risk is borne by the user of these capital funds. Justice, which is a hallmark of the Islamic system, demands that provider of capital funds should share the risk with the entrepreneur if he wishes to earn profit. It is easy to see, therefore, that the mark-up system, and for that matter all devices which involve a fixed predetermined return on capital, are no real substitutes for interest". Ziauddin Ahmed, *Concept and Models of Islamic Banking : An Assessment*, Islamabad, 1984, p. 11. For some other views on the subject, see Abbas Mirakhor, "The Progress of Islamic Banking : The Case of Iran and Pakistan" in Chibli Mallat (ed.), *Islamic Law and Finance*, London, 1988, pp. 91 - 113. Dr. Mirakhor refers to these techniques as 'weak' and argues that even in the transition to full Islamic banking, the policy of heavy reliance on weakly Islamic measures as means of minimising risk may not be optimal. *Ibid.*, pp. 95 - 96 and *Idem*, "Short-term Asset Concentration and Islamic Banking" in Mohsin S. Khan and Abbas Mirakhor (eds.), *Theoretical Studies in Islamic Banking and Finance*, Houston, U. S. A., 1987, pp. 186 - 188; See also Zubayr Iqbal and Abbas Mirakhor, "Islamic Banking" in *al-Tawhid*, Vol. IV (3), 1986, pp. 94 - 103; see also M. N. Siddiqi, *Issues in Islamic Banking : Selected Papers*, Leicester, U. K., 1983, pp. 133 - 145; Mohsin S. Khan and Abbas Mirakhor, "The Framework and Practice of Islamic Banking" in *Finance and Development*, September 1986, pp. 33 - 34; Shahrukh Rafi Khan, "An Economic Analysis of a PLS Model for the Financial Sector" in Mohsin S. Khan and Abbas Mirakhor (eds.) (1987), *Theoretical Studies in Islamic Banking and Finance*, pp. 107 - 124; Nadeem Ul Haque and Abbas Mirakhor, "Saving Behaviour in an Economy Without Fixed Interest" interest" in *Ibid*, pp. 125 - 139; *Idem*, "Optimal Profit-Sharing Contracts and Investment in an Interest-Free Economy" in *Ibid.*, pp. 141 - 161.

⁴⁸ To put this in the form of an adage, one could state with respect to all financing operations: "No risk, no gain".

However, cautioning against the danger that such methods could open a back-door for interest,⁵⁰ it is emphasised that their use should be kept to the minimum extent that maybe unavoidably necessary under given conditions and that their use as general techniques of financing must never be allowed.⁵¹

The Muslim monetary authorities, on the other hand, argue that adoption of fully Islamic banking on the basis of risk-return is embarking "on an uncharted course"⁵² and that steps towards full implementation of Islamic banking must be taken cautiously and carefully, lest the financial structure "collapse under its own weight".⁵³ They assert that in addition to being compatible with Islamic norms, the banking operations adopted must be viable because:

The bank's money belongs to a number of depositors of all shapes and sizes: the big shots are there, but also ordinary people who make deposits as small as RS. 1000 in their accounts. That money is channeled to borrowers by the bank, which is also a trustee of that money. The system should be such that it protects the depositor and also gives him an adequate rate of return. Unless

⁴⁹ M. U. Chapra (1991), "Towards an Islamic Financial System", p. 139.

⁵⁰ A group of Muslim economists who were invited to comment on the *CII Report* (see Ziauddin Ahmed, et al (eds.) (1983, p. 12), strongly cautioned "against the danger that such methods could open a back door to interest", and they emphasized that "keeping in view the rationale for the condemnation and prohibition of interest in Islam, no mechanism other than profit/sharing really conforms to the spirit of Islam". Moreover, there is evidence to suggest that these scholars were justified in their concern. For instance, Qureshi comments that *murābahah* transactions "have been the subject of acute criticism because (this kind of arrangement) is tending to encompass the bulk of financial transactions. See D. M. Qureshi, "Investment Financing on the Basis of Shared Risk", p. 15. A Paper presented at the *First Workshop on "Interest-Free Banking"*, Karachi, Pakistan, 1985. The fear that this would happen had been expressed earlier by M. N. Siddiqi in his comment on *CII Report*, p. 225.

⁵¹ *CII Report*, p. 110; *Towards*, p. 171.

⁵² A. G. N. Kazi, "Islamic Banking in Perspective" in *JIBF*, Vol. I(3), (Karachi, 1984), p. 9.

⁵³ *Ibid.*, p. 13.

we safeguard the interest of the depositor, the system will be totally unfair because it will be lacking in 'adl (justice) which is essential in any Islamic system.⁵⁴

Clearly, although the Muslim monetary authorities agree that ideally the Islamic financial system should be based on risk-return sharing, however, as trustees of public money, they are concerned with the safety of the bank first and wish to avoid bankruptcy and the failure of the bank. The statement elsewhere warns that "...the structure which we have should be a viable structure which will protect the banking system itself and which does not lead to the collapse of the banking system".⁵⁵

This cautious concern with the safety of the banking system is essentially based on a type of moral hazard argument that, in the absence of Islamic ethical values functioning in the business community,⁵⁶ engaging in risk-return activities such as *muḍārabah* and *mushārah* by the banks without adequate safeguards may lead to the bankruptcy of the banks.⁵⁷ This legitimate concern of the authorities translates into policies which approach Islamic banking with the utmost caution, thus resulting in heavy reliance on weakly Islamic modes of finance, such as *murābahah*, which have a minimum probability of risk.

⁵⁴ *Ibid.*, p. 13.

⁵⁵ *Ibid.*, p. 10.

⁵⁶ Qureshi argues that "the successful functioning of the profit and loss sharing system will depend on the existence of a high degree of business ethics and the moral fabric of the society leaves much to be desired", he concludes that "initially, therefore, recourse may have to be taken to techniques which are not predicated on the maintenance of proper books of accounts". See D. M. Qureshi, "Instruments of Islamic Banking in the Muslim World : An Evaluation", p. 89. A Paper presented at the *International Seminar on Islamic Banking*, Islamabad, 1984.

⁵⁷ See Chapra (1985), pp. 223 - 227; *Idem*, *Islam and the Economic Challenge*, Leicester, 1992, pp. 235 - 248.

3.3. The Establishment of *Bank Islam Malaysia Berhad (BIMB)*⁵⁸

3.3.1. Historical perspectives

The Muslims in Malaysia, like their counterparts elsewhere, have for a long time had the desire to practise the rules of the *Shari'ah* in the fields of banking and finance. They have always been cautious about being involved in *ribā* transactions.⁵⁹ They had developed their own transactions which avoided *ribā*. One such customary transaction which was prevalent amongst the Malays in pre-colonial times, and has survived until now, is *jual janji* (conditional sale).⁶⁰

The origin of *jual janji* has been attributed to the objection that Malays (as Muslims) have towards *ribā*, which is the economic basis on which the modern system of charge or mortgage functions. The answer to this objection, which proceeds

⁵⁸ Hereafter referred to as *BIMB*.

⁵⁹ Article, "Economic and Financial Development of Muslim Society", in *al-Nahdah*, Vol. VII (4), (Kuala Lumpur, 1987), pp. 20 - 22; Nik Mustapha Nik Hassan, "Pendekatan Sistem Ekonomi Islam Dalam Meningkatkan dan Memajukan Kedudukan Ekonomi Masyarakat Melayu", in *Occasional Paper Kulliyah of Economics*, International Islamic University, Malaysia, June 1989, pp. 8 - 11; See also Ibrahim Omar, "Sistem Kewangan Islam Memasuki Dagangan Antarabangsa", in *Dakwah*, (Kuala Lumpur, November 1984), pp. 43 - 45; Nungsari Ahmad Radhi, "Wang, Kadar Bunga dan *Ribā*", A Paper Presented at the *Seminar Kursus Ekonomi Islam*, Jitra, Kedah, 1987; Sobri Salamon, *Perniagaan Menurut Pandangan Islam*, Shah Alam, Malaysia, 1988, pp. 120 - 124; Fokus, "Masalah Bank dan Saham : Penyelesaiannya Cara Islam", in *Dunia Islam*, (Kuala Lumpur, July 1991), pp. 21 - 28; Khoo Kay Kim, "Islam and Economic Development in Malaysia : A Historical Perspective", A Paper presented at the *International Seminar on Islam and Development in Southeast Asia*, 25 - 26 September 1991, Kuala Lumpur; Zakariya Man, "Ribā dan Kadar Bunga : Penilaian dan Penjelasan Kepada Isu Semasa", A Paper presented at the *Siri Seminar Ekonomi Islam*, 18 - 19 January 1994, Kuala Lumpur.

⁶⁰ The English term is translated by Maxwell. (See W. E. Maxwell, "The Law and the Customs of the Malays with Reference to the Tenure of Land", *Journal of the Straits Branch of the Royal Asiatic Society*, No. XIII, June 1884, p. 123; Cf. M. B. Hooker, *Reading in Malay Adats Laws*, Singapore, 1970, pp. 354 - 361; J. M. Gullick, *Malay Society in the Late Nineteenth Century*, Singapore, 1987, pp. 98 - 149). Though Maxwell's translation 'conditional sale' is conceptually correct, 'promissory sale' is more precise. The Customary practice of *jual janji* is recognised in the *National Land Code (NLC)*, Section 4(2).

from the Islamic injunctions against *ribā*, is the transaction known as *bay' bi al-wafā'*, which is the sale with an option to repurchase.⁶¹

The identification of *jual janji* as a local customary transaction peculiar to the Malays because of religious considerations received judicial notice from the British judge, Briggs, in the case of **Tengku Zahara v. Che Yusuf** (1951 17 MLJ 1), in which he held that:

The whole purpose of *jual janji* transactions is to provide a procedure for securing loans and giving the lender adequate recompense therefore without infringing the prohibition of usury which is binding on the conscience of all good Muslims.

In **Mohamed Isa v. Haji Ibrahim** (1968 1 MLJ 186), Azmi, Chief Judge (Malaya) made a similar observation regarding this religious element when he said that amongst the Kedah Malays, the transaction of *jual janji* was in fact, " a conditional transfer with a right to repurchase and so made in order to enable the lender to benefit from the transaction lawfully to Muslim law".

Realising that the prohibition of *ribā* for Muslims, had led to growing demands

⁶¹ Under this practice, if a land owner would like to obtain a credit facility without involving *ribā*, he could sell his land to another person at an agreed price. Normally, the price is not the market price but far cheaper. In agreement, a condition was stipulated that within a certain period of time (say 2 or 3 years), the seller would re-purchase the land at the same price. The buyer was given a right to occupy the land as well as have usufructuary right. If the time stated has expired and the seller failed to re-purchase the land, the ownership of the land is, therefore, transferred to the buyer. This transaction was considered acceptable by Islam as no *ribā* element was involved. For detail, see S. Buang, "Kearah Pengislaman Kanun Tanah Negara", in Law Faculty, University of Malaya, *Makalah Undang-undang Menghormati Ahmad Ibrahim*, Kuala Lumpur, 1988, pp. 175 - 176; *Idem*, "The law of Real Property in Malaysia" in *IIU Law Journal*, Vol. I (1), Petaling Jaya, Malaysia, 1989, pp. 97 - 98; *Idem*, *Malaysian Torrens System*, Kuala Lumpur, 1989, pp.87 - 88. However some criticised *Jual janji* as one way to circumvent the prohibition of interest (*ribā*). See S. Gordon, "Contradictions in the Malay Economic Structure" in *Intisari*, Vol. I(1), Singapore, 1963, pp.30 - 32.

for the establishment of an Islamic bank in Malaysia.⁶² In the early 1960s, the first major move towards establishing an interest-free financial institution was the setting up of the *Tabung Haji* (Pilgrims' Management and Fund Board). The success of *TH* in mobilising the funds of the depositors in accordance with Islamic principles put pressure on the Government to establish an Islamic bank.⁶³ Further, the desire of the Muslims in Malaysia was especially rekindled when, in the early 1970's there was a successful move to establish Islamic banks in West Asia such as the Islamic Development Bank in 1974 which operates in Jeddah, Saudi Arabia.⁶⁴

A more formal demand for the establishment of an Islamic bank in Malaysia was first made in 1980 when the *Bumiputera Economic Congress* passed a resolution urging the Government to allow the Pilgrims' Management and Fund Board to establish an Islamic bank in Malaysia in order to mobilise and invest the funds of the Muslims in the country in accordance with *Shari'ah* principles.⁶⁵ Implementation of such a resolution began in 1981 under Dr. Mahathir, the Prime Minister of Malaysia, when he invited prominent international Muslim scholars to Malaysia and accepted their recommendation on how Government could Islamise the administrative

⁶² Sobri Salamon, "Prinsip-Prinsip Falsafah Ekonomi Bank Islam", in *Dakwah*, (Kuala Lumpur, May 1982), pp. 43 - 46; Idem, "Falsafah Ekonomi Bank Islam : Mengapa Malaysia Perlu Kepada Bank Islam", in Muhammad Syukri Salleh (ed.), *Konsep dan Pelaksanaan Pembangunan Berteraskan Islam*, Pulau Pinang, 1990, pp. 77 - 101; Tony Naughton and Bala Shanmugam, "Interest-Free Banking in Malaysia", in *National Westminster Bank Quarterly Review*, February 1990, p. 22.; Cf. Muhammad Abu Bakar, "Islamic Revivalism and the Political Process in Malaysia", *Asian Survey*, Vol. XXi (10), 1981, pp. 1041 - 1059.

⁶³ See Chapter Five, 5.1, pp. 254 - 257.

⁶⁴ See Chapter III, 3.1. b and c., pp. 135 - 137.

⁶⁵ Abdul Halim Ismail (1983a), "Bank Islam Malaysia Berhad : Establishment and Operations", p. 1. Paper presented at the *International Conference on Islam and Technology*, Malaysia, December 1983. Hereafter referred to as Abdul Halim Ismail (1983a); *BIMB, Bank Islam : Penubuhan dan Operasi*, Kuala Lumpur, 1989, p. 3; See also, M. Muttalib, "Islamic Revivalism in Asian States : Political Implications", *Asian Survey*, Vol. XXX (9), 1990, pp. 881 & 889; Abdul Monir Yaacob, "Merealisasikan Sistem Pinjaman Rahan" in *Berita Harian*, 22 October, 1993, p. 10.

machinery of the country by setting up Islamic institutions such as banks and universities.⁶⁶ Likewise at the National Seminar on the *Concept of Development in Islam*, which was held at Universiti Kebangsaan Malaysia in Bangi in March 1981, a resolution was passed requesting the Government of Malaysia to take immediate steps to legislate an Act which would enable the setting up of banks and financial institutions whose operations would be based on Islamic principles.⁶⁷ On the same occasion, Dr. Mahathir announced the setting up of an Islamic Research Group and a Special Enforcement Group with the task of conducting research on all issues relating to an Islamic economic system, as well as assisting the Government's development projects by ensuring that they conform to Islamic principles.⁶⁸ Their efforts finally culminated in the appointment by the Prime Minister of a National Steering Committee on the Islamic Bank on 30 July 1981.⁶⁹ The twenty-member Steering Committee headed by the Raja Tan Sri Mohar, the special advisor to the Prime Minister, was given the following tasks:

- a. To study and identify various critical aspects of Islamic banking such as the basis of the establishment, areas of operation, and business relationship with the customers and other financial institutions.
- b. To examine the suitability of Islamic banking in the Malaysian context from various points of view including religious, legal, racial, social and

⁶⁶ H. Mutalib, *Islam and Ethnicity in Malay Politics*, Singapore, 1990, p. 138; Aidit Ghazali, *Development : An Islamic Perspective*, Petaling Jaya, 1990, pp. 142 - 144; Cf. Diane K. Mauzy and R. S. Milne, "The Mahathir Administration in Malaysia : Discipline Through Islam", *Pacific Affair*, 56 (Winter 1983 - 84), pp. 617 - 648; William Case, "Comparative Malaysian Leadership Tunku Abdul Rahman and Mahathir Mohamad", *Asian Survey*, Vol. XXXI (5), 1991, pp. 456 - 473;

⁶⁷ Abdul Halim Ismail, "Bank Islam Malaysia Berhad : Structure and Functions", pp. 1- 2. Paper presented at the *Seminar on Current Trends and Development of the Banking Industry in Malaysia*, Bangi, Malaysia, 1983. Hereafter referred to as Abdul Halim Ismail (1983b); *BIMB* (1989), *op. cit.*, p. 3.

⁶⁸ H. Mutalib (1990), *op cit.*, p. 138.

⁶⁹ *BIMB* (1989), pp. 3 - 4.

development angles; and

- c. To present to the Government of Malaysia a proposal to establish *Bank Islam Malaysia* in a complete report encompassing the following aspects: (i) fundamental concepts of Islamic banking; (ii) legal framework; (iii) structure of the company; (iv) area of operation; and (v) organizational structure.⁷⁰

3.3.2. Basic Principles of the *Bank Islam Malaysia Berhad*

The report of the National Steering Committee on the Islamic Bank of Malaysia outlines three major principles that should govern the operation of the Bank Islam:

- a. The prohibition of *ribā* and the sharing of profit and loss. Profit and loss-sharing is the basis of all economic activities involving money, wealth and labour in Islam. This concept of profit-sharing should replace interest as an important mechanism in the present banking system.
- b. Management of Islamic bank based on Islamic transactions (*mu'āmalah*). The success of an Islamic bank is largely dependent on the understanding and implementation of the Islamic principle of transactions on the part of the management. Thus, an Islamic bank must ensure that its activities will not be in conflict with the *Shari'ah* (Islamic Law).
- c. Avoidance of activities contradictory to the interest of the Muslim *ummah*. Any activity which is not in conformity with the interest of the *ummah* is

⁷⁰ Ahmad Ibrahim, "The *Shari'ah* and Codification: Malaysia Experience", in *Shariah Law Journal*, Vol. IV, (Petaling Jaya, January 1987), pp. 58 - 59; Zakariya Man, "Islamic Banking : The Malaysian Experience" in Mohamed Ariff (ed.), *Islamic Banking in Southeast Asia*, Singapore, 1988, p.70.

tantamount to misuse and abuse of the wealth entrusted by God.⁷¹

The National Steering Committee submitted its report on 5 July 1982, and the report was accepted by the government. The recommendations of the committee included the following:

- a. An Islamic bank which operates according to the principles of *Shari'ah* should be established.
- b. The bank should be incorporated as a limited company under the *Company Act* 1965.
- c. An act styled the *Islamic Banking Act* 1983 should be legislated and some consequential amendments should be made to other existing related Acts.
- d. *Bank Negara* (Central Bank) should administer the *Islamic Banking Act* 1983.
- e. The bank should set up a Religious Supervisory Council to ensure that the operations of the Bank comply with the principles of the *Shari'ah*.⁷²

3.3.3. Legal and Regulatory Framework of *BIMB*

(a) Incorporation

The Bank Islam was finally incorporated as a limited company under the

⁷¹ *BIMB* (1989), pp. 4 - 5; Bank Negara Malaysia, *Wang dan Urusan Bank di Malaysia*, Kuala Lumpur, 1992, pp. 216 - 218 and 477; Abdul Samad bin Haji Alias, et al, *Guide to Islamic Banking in Malaysia : An Overview*, Kuala Lumpur, 1993, p. 2. See also Ahmad Ibrahim, "The Administration of Islamic Financial Institutions", in *Syariah Law Journal*, Vol. VII, (Petaling Jaya, September 1991), pp. 16 - 17.

⁷² Abdul Halim Ismail (1983a), p. 2; *Idem*, " Bank Islam malaysia Berhad : Principles and Operations" in Sheikh Ghazali Sheikh Abood, et al (eds.), *An Introduction to Islamic Finance*, Kuala Lumpur, 1992, p. 244; *BIMB* (1989), p. 4; Ahmad Ibrahim, "Legal Aspect of the Establishment of the Islamic Law", a working paper presented at the *International Conference on Islam and Technology*, Kuala Lumpur, 1985, pp. 11 - 13.

Company Act 1965 on 1 March 1983 taking the name of *Bank Islam Malaysia Berhad (BIMB)* with its registered office situated in Malaysia. Its memorandum of Association prefaces that "*all businesses of the company will be transacted in accordance with Islamic principles, rules and practices*". It lists among the company's first objectives as "to carry on the Islamic banking business in all its branches and departments and to transact and do all matters and things incidental thereto, or which may at any time hereafter at any place where the company shall carry on business be usual in connection with the Islamic banking business". The memorandum then proceeds to enumerate a number of possible objects for which the company is established, and seals the listing with a proviso that "nothing in this memorandum contained also shall empower the company to carry on any business or do anything involving any element which is not approved by the religion of Islam".⁷³

To carry out its activities on interest free basis, the bank has an authorized capital of RM 500 million, divided into 500 million ordinary shares of RM 1.00 each and the initial paid-up capital of the bank is RM 80 million, which is RM 20 million less than the amount recommended by the National Steering Committee.⁷⁴ The initial paid-up capital then held by the Malaysian Government and various other parties was as follows:

⁷³ Abdul Halim Ismail (1983a), pp. 2 - 3; *Idem* (1992), *op. cit.*, pp. 245 - 246.

⁷⁴ Abdul Halim Ismail (1983a), p. 3; *BIMB* (1989), p. 6; Article, "Islamic Banking in Malaysia", *Banker's Journal*, Malaysia, No. 52, April, 1989, pp. 63 - 64.

Shareholders	RM Million
Government of Malaysia	30
Lembaga Urusan dan Tabung Haji (LUTH)	10
Muslim Welfare Organization of Malaysia	5
State Religious Councils	20
State Religious Agencies	3
Federal Agencies	12
Total	80

Source : *BIMB, Penubuhan dan Operasi*, Kuala Lumpur, 1989, p. 6; *Bank Negara Malaysia, Annual Report 1987*, pp. 16 - 17.

Table : 2

Commercial Banks (Locally Incorporated) : Assets, Deposits and Shareholders' Funds (RM Million) (As at 31 December 1984)

Name of Institution	Assets	Deposits	Shareholders' Funds	Ranking
Malayan Banking Berhad **	22,067.9	14,066.8	1,132.1	1
Bank Bumiputera Malaysia Berhad	21,102.4	14,658	1,074.5	2
Public Bank Berhad	5,811.9	4,785	319	3
United Malayan Banking Corporation Berhad*	7,494.3	4,517.4	200.9	4
Development and Commercial Bank Berhad	4,154	2,999.1	174.5	5
United Asian Bank Berhad*	3,543.9	2,161.9	132.7	6
Bank Islam Malaysia Berhad (BIMB)*	563.4	279.6	80.4	7
Perwira Habib Bank Berhad	2,346.1	1,844.7	76.4	8
Malayan United Bank Berhad	1,540	1,262	75	9
Hock Hua Bank Berhad	1,313.3	973.4	74.4	10
Kwong Yik Bank Berhad	1,341.3	1,090.2	72.7	11

Notes:

* Position as at 31 December 1983

** Position as at 30 June 1985

Source : Arab-Malaysian Merchant Bank Berhad, *The Kuala Lumpur Bankers Directory*, 1986.

Based on the shareholders' funds of the bank which amounted to RM 80.4 millionas at 31 December 1984 , the *BIMB* can be placed among the seven largest locally incorporated commercial banks in Malaysia. This comparison is clearly shown in Table 2. Based on these comparisons, obviously the *BIMB* has a sound base to conduct its operations and to gain the people's confidence. The confidence of the people towards the bank also stems from the fact that the Government and other major religious agencies and Muslim institutions in the country have contributed to the bank shareholders' funds. It is significant to note that the *BIMB* is the first Islamic bank to be established with direct Government involvement, while other earlier Islamic commercial banks in other Muslim countries were established mainly by private individuals.⁷⁵

(b) *Islamic Banking Act (IBA) 1983*⁷⁶

The *Banking Act* 1973 requires the rate of interest to be an important mechanism for banking operations and prohibits banks from trading.⁷⁷ In contrast, the *Qur'ān* explicitly states that, "Allāh has permitted trade and prohibited interest (*ribā*)".⁷⁸ This divergence between the *Banking Act* 1973 and the Qur'ānic injunctions implies that the initial legal environment in Malaysia did not permit the establishment of an Islamic bank that would operate without the element of interest.

⁷⁵ For example *Dār al-Māl al-Islāmi* and al-Baraka Group. See Ausaf Ahmad (1987), pp. 14 - 15.

⁷⁶ Hereafter referred to as *IBA* 1983.

⁷⁷ *Banking Act*, 1973 (Act No. 1202, 1973), section 31.

⁷⁸ Q. 2 : 275.

In view of the above conflict, the Islamic Banking Act was legislated towards the end of 1982 to facilitate the establishment of *Bank Islam*. The Act, which was gazetted on 10 March 1983, is now known as the *Islamic Banking Act 1983* (Act No. 276, 1983). The Act seeks to provide for the licensing and regulating of the *Bank Islam* business. It has been modelled on the country's *Banking Act 1973* (now amended by the *Banking and Financial Institution Act (BAFIA), 1989* with modifications and amendments as are necessary to conform with Islamic banking practises. It basically retains the normal practices of prudent banking contained in the *Banking Act 1973*⁷⁹ and vests the Central Bank (*Bank Negara*) with similar powers of supervision and regulation over Bank Islam as in the case with other licensed banks.⁸⁰

(c) Salient Features of the *Islamic Banking Act 1983*

The following are the major provisions of the *IBA 1983* as compared with the *BAFIA 1989*:

- a. Definition section (*IBA*, Section 2) defines an Islamic bank as "any company which carries on Islamic banking business".
- b. Definition of "Islamic banking business". According to Section 2 *IBA 1983*, "Islamic banking business" means "banking business whose aims and operations do not involve any element which is not approved by the Religion of Islam". This definition surely poses

⁷⁹ Article, "The Law and Banking", in *Banker's Journal Malaysia*, (Kuala Lumpur, June, 1987), p. 17.

⁸⁰ *Bank Negara Malaysia, Wang dan Urusan Bank di Malaysia*, Kuala Lumpur, 1992, pp. 103 -167. See also Badariah Sahamid, "Bank Islam : Konsep dan Amalan" in Faculty of Law, University of Malaya, *Makalah Undang-Undang Menghormati Ahmad Ibrahim*, Kuala Lumpur, 1988, pp. 79 - 80.

the question: What is Islamic banking business? It has been clarified through various lectures given by *BIMB*'s officials and its handbook that the banking mechanism of *BIMB* is as mentioned below (3.5), i. e. *muḍārabah*, *mushārah*, *murābahah*, *bay' bi thaman ājil*, *bay' salam*, *ijārah*, *wadī'ah*, *wakālah*, *kafālah* and *qard ḥasan*.⁸¹ However, these concepts and principles are not laid out in detail in the Act. Having a first glance at the Act, one could feel that there is nothing Islamic about the whole Act except for where it states "... aims and operation not contrary to the religion of Islam". However, Section 2 of *BAFIA 1989* defines "banking (and finance) business" as:

The business of receiving money in any currency or deposit accounts; paying and collecting cheques drawn by or paid in by customers and provision of finance, which include the lending of money, leasing business, factoring business, the purchase of bills of exchange, promissory notes, certificates of deposits, debentures or other negotiable instruments; and acceptance or guarantee of any liability, obligation or duty of any person and includes such other business as the Central Bank, with the approval of the Minister may prescribe.

In the absence of a statutory definition of "banking business" in the *IBA 1983*, it is the practice and in fact the law, to have regard to the Common Law to determine its meaning.⁸² It would appear therefore that the *IBA 1983* intends to define "Islamic banking business" in similar terms as that carried out by conventional banks in Common Law jurisdiction.⁸³ The only exception is that the aims and operations

⁸¹ See also *Bank Negara Malaysia, Wang dan Urusan Bank di Malaysia*, pp. 216 - 218.

⁸² Ahmad Ibrahim (1987), "The *Sharī'ah* and Codification: Malaysia Experience", p. 59 - 60; see also *Idem* (1985), "Legal Aspects of the Establishment of the Islamic Law", pp. 11 - 12.

⁸³ See Section 2 of *Banking and Financial Institution Act (BAFIA), 1989*.

of such banking business should not involve any element which is not approved by the religion of Islam.⁸⁴

c. Engaging in Trade and Commerce.

The fundamental principle of Islamic finance is trading and profit and loss sharing. Islamic banks have to trade to earn an income since the Qur'ān expressly forbids *ribā* but allows profit-making by trading.⁸⁵ However, according to Section 31, *BAFIA 1989*, conventional banks and financial institutions are not allowed to engage in wholesale or retail trading. Therefore, this provision is absent in the *IBA 1983* which enables the Islamic bank to engage in such trade and commerce and is in line with the *Shari'ah*.

(d) *Government Investment Act 1982*

According to the *Shari'ah* rules, an Islamic bank is not allowed to trade in Treasury Bills or other papers such as Government Bonds or securities which are interest-based transactions. From the operation point of view, however, it is important for the *BIMB* to trade in these papers in order to meet its legal liquidity requirements.⁸⁶ In order to make the operations of *BIMB* possible, consequently, The Investment Act 1982 was passed enabling the Government to issue non-interest

⁸⁴ See Section 2 of *IBA 1983*.

⁸⁵ Q. 2 : 275 : "...But Allāh has permitted trade and forbidden usury".

⁸⁶ *Bank Negara Malaysia, Wang dan Urusan Bank di Malaysia*, pp. 216 and 406.

bearing investment certificates so as to meet *BIMB*'s liquidity requirements⁸⁷ in terms of its holdings of liquid assets as well as to provide an investment avenue for its excess funds. The issuance of Government Investment Certificates (GIC) which is governed by the principle of *qard ḥasan* represents a benevolent loan to the Government, except that there is no pre-determined rate of interest. The holder of these Certificates also does not expect any returns on the capital except the principle amount invested which will be fully refunded upon maturity.⁸⁸

(e) Religious Supervisory Council

BIMB has set up a Religious (*Shari'ah*) Supervisory Council to supervise and advise its banking operations to ensure that its operations do not involve any element which is not permissible in *Shari'ah*,⁸⁹ This Council has a minimum of three and a maximum of seven members of eminent Muslim Religious Scholars in the country.⁹⁰

⁸⁷ The certificates are, however, not limited to *BIMB*, but are also made available to others in the financial system which represent borrowings by the Government for its development expenditure. See Jaffar Hussein, "Facing the Challenge of Islamic Finance", in *al-Nahdah*, Vol. VII (4), (Kuala Lumpur, 1987), p. 26; *Bank Negara Malaysia, Wang dan Urusan Bank di Malaysia*, p. 406.

⁸⁸ However, at the discretion of the Government, *BIMB* will be paid some dividends at the maturity of these Certificates and the rate of dividends is to be determined by the Minister of Finance. *Bank Negara Malaysia, Wang dan Urusan Bank di Malaysia*, p. 406; Article, "Islamic Banking in Malaysia", in *Banker's Journal Malaysia*, April 1989, p. 65.

⁸⁹ The *Islamic Bank Act 1983* states on the licensing of Islamic banks that : "The Central Bank shall not recommended the grant of license, and the Minister shall not grant a license, unless the Central Bank or the Minister, as the case may be, is satisfied: (b) that there is, in the articles of association of the bank concerned, provision for the establishment of a *Shari'ah* advisory body to advise the bank on the operations of its banking business in order to ensure that they do not involve any element which is not approved by the Religion of Islam".

⁹⁰ Accordingly, Article (3) of the Bank's Articles of Association provide that : (a) "A Religious Supervisory Council, whose members would be made up of Muslim Religious scholars in the country, shall be established to advise the company on the operations of its banking business...; (b) The Religious Supervisory Council shall have a minimum of three and a maximum of seven members whose appointment shall be acceptable to the Minister for a term not exceeding two years and each member is eligible for reappointment".

The supervisory role of the Religious Supervisory Council has been criticised in the following words:

Although the *Shari'ah* Advisory Body has the power to advise, it is questionable as to how far it is able to perform such a function. It must be remembered that the Central Bank supervises the whole banking system and therefore the ultimate power rests with the Central Bank. I can understand the government's position in protecting its interest of the Bank's paid up capital but it is quite pointless to set up an Islamic institution but to have it supervised by a non-Islamic organisation.⁹¹

3.4. Corporate organisation

3.4.1. Corporative objective

In view of the primary objective for which it is set up, *BIMB* has formulated its corporative objective as follows:

The corporate objective of the Bank is to provide banking facilities and services in accordance with Islamic principles, rules and practices to all Muslims and the population of this country. The Bank's effort to provide these banking facilities and services is to be undertaken within the framework of its viability and capability to continuously grow and expand.⁹²

3.4.2. Organizational structure

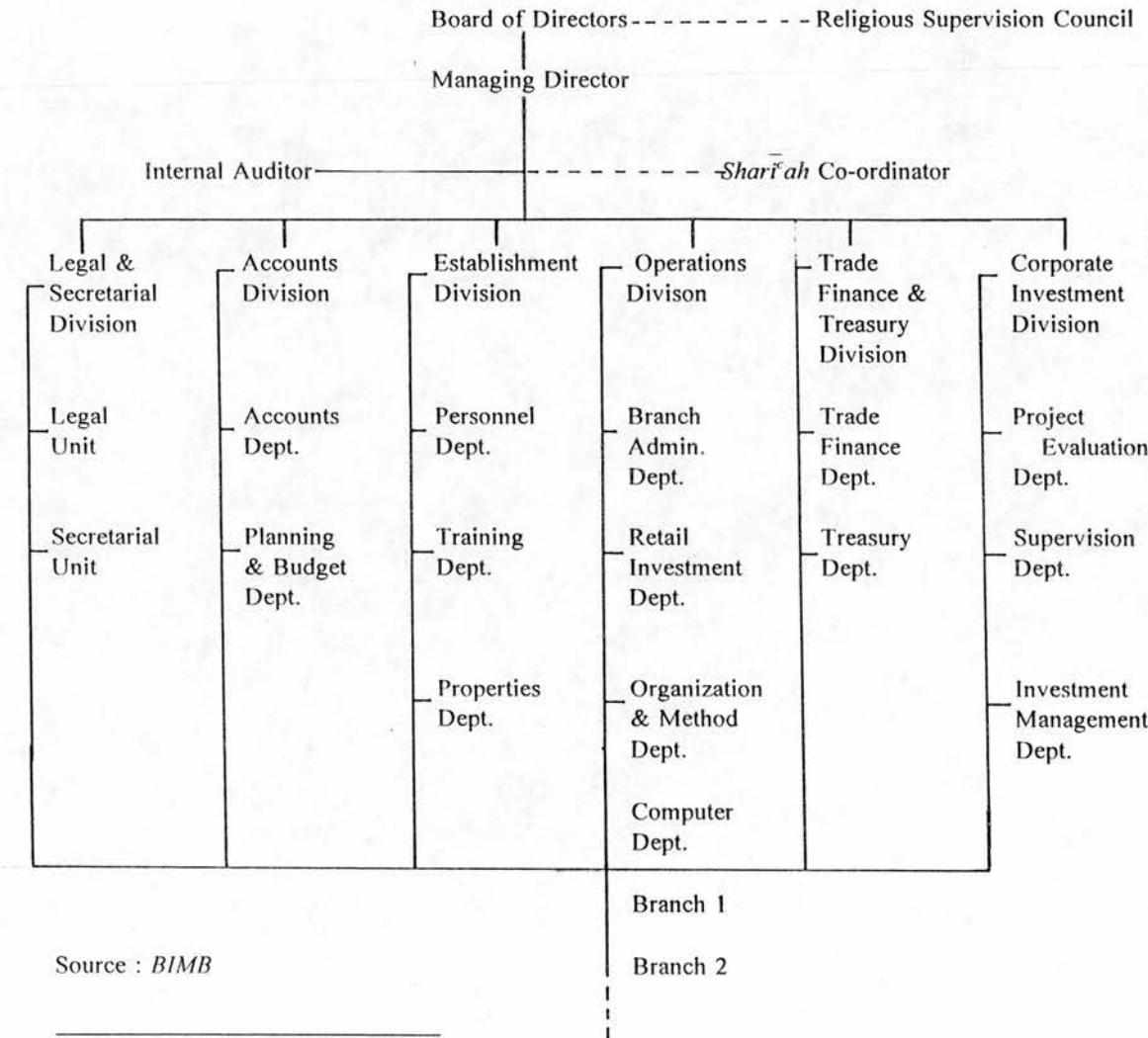
The Organizational structure of *BIMB* is shown in the figure 3.2. The structure consists of three divisions with line functions, i. e. operations, trade finance and treasury, and corporate investments and three other divisions with staff functions, i.

⁹¹ N. Mohd. Awal, "Banking System : Legal Impediment Towards Its Islamisation in Malaysia" in *Jurnal Perundangan*, Vol. I(1), (Petaling Jaya, 1989), p. 28.

⁹² Abdul Halim Ismail, "*Bank Islam Malaysia Berhad : Structure and Functions*". A Paper presented at the *Seminar on Current Trends and Development of the Banking Industry in Malaysia*, in Bangi, Selangor, Malaysia, 6 - 7 June 1983; See also *idem*, "*BIMB : Satu Tinjauan Tentang Perkembangannya 10 Tahun Akan Datang*", p. 3. A Paper presented at the *Seminar Sistem Kewangan Islam*, Universiti Kebangsaan Malaysia, Bangi, 1984.

e. establishment, accounts and legal, and secretarial. Each division is divided into departments and further subdivided into units as deemed necessary. *BIMB* has its Board of Directors comprising the nominees of its major shareholders who are elected at the annual general meetings. The management of the Bank is spearheaded by the Managing Director. The Managing Director and the Internal Auditors report to the Board of Directors. Meanwhile, the Religious (*Shari'ah*) Supervisory Council advises the Board of Directors on all areas of operations related to religious affairs.⁹³

Figure 3.2 : *Bank Islam Malaysia Berhad* : Organizational Structure



Source : *BIMB*

⁹³. Abdul Halim Ismail (1983a), p. 6; *Idem* (1992), pp. 247 - 248.

3.4.3. Subsidiaries and Branch Network

BIMB formed three subsidiary companies during its second financial year (1 July 1984 to 30 June 1985). For the purpose of acquisition of immovable and movable fixed assets, *BIMB* formed a wholly-owned subsidiary company with a paid-up capital of RM \$ 1 million under the name of *Syarikat al-Ijarah Sendirian Berhad*. Another wholly-owned subsidiary company with a paid-up capital of RM 25,000, known as *al-Wakalah Nominees Sendirian Berhad* was formed to provide portfolio investment management and nominee services for *BIMB* and its clients.⁹⁴ A third subsidiary company is the 51-per cent owned *Syarikat Takaful Sendirian Berhad* which is engaged in *takāful* (Islamic Insurance) business in both family *takāful* business as well as general *takāful* business. The company began its Islamic insurance operation in the financial year 1985/86.⁹⁵

As at 30th June 1993, *BIMB* had successfully opened 44 full-service branches in almost all the major towns in Malaysia, including 32 mini branches which accept deposits in current, savings and investment account facilities.⁹⁶

3.5. Banking Operations

BIMB commenced its business operations on July 1, 1983 to meet the savings

⁹⁴ *Bank Negara Malaysia, Annual Report 1987*, p. 110.

⁹⁵ *BIMB, Annual Report 1986*, p. 7; *Syarikat Takaful Malaysia Sendirian Berhad, Annual Report 1986*, p. 5.

⁹⁶ *BIMB, Annual Report 1993*, p. 11.

and credit need of the Malaysians in general and the Muslim community in particular.⁹⁷ In line with the basis of the Bank's establishment and its corporate mission, all of its banking operations and activities are in accordance with the principles of *Shari'ah* such as *wadi'ah*, *muḍārabah*, *mushārah*, *murābahah*, *bay' bi thamān ājil*, *ijārah*, *wakālah*, *kafālah* and *qard ḥasan*.⁹⁸

3.5.1. Customers' Deposits

There is a consensus among scholars and practitioners of Islamic banking that deposits can be mobilised using the two *Shari'ah* contracts, i. e. *wadi'ah* and *muḍārabah*.⁹⁹ In the case of *BIMB*, deposits are received from its ordinary customers through the following three accounts, namely:

- (a) current accounts;

⁹⁷ See Mahathir Mohamad, the Prime Minister's speech on the opening of the operations of *BIMB* on the First of July, 1983 published in *Koleksi Ucapan Mahathir Mohamad*, Kuala Lumpur, 1992, pp. 84 - 89.

⁹⁸ Abdul Halim Ismail (1983a), pp. 7 - 8; *Idem*, "Pelaburan Harta Baitulmal Melalui Bank Islam dan Syarikat Takaful", pp. 3 - 4. A Paper presented at the *Seminar Baitulmal Peringkat Kebangsaan*, Bangi, 1984/85; *Idem*, "Bank Islam : Prospek dan Perkembangannya Pada Masa Hadapan", pp. 1 -5. A Paper presented at the *Seminar Pengajian Islam Peringkat Kebangsaan*, Universiti Malaya, 1985; *Idem*, "Bank Islam Sebagai Satu Institusi Pembangunan Masyarakat Islam" in Muhammad Syukri Salleh (ed.), *Konsep dan Pelaksanaan Pembangunan Berteraskan Islam*, Pulau Pinang, Malaysia, 1990, pp. 69 - 76; *Idem*, (1992), p. 271; *Bank Negara Malaysia, Annual Report 1984*, p. 75; *BIMB, Annual Report 1986*, p. 7; *BIMB* (1989), *Penubuhan dan Operasi*, 28 pp.; Tajuddin Abdul Rahman, "Peranan Bank Islam Dalam Membantu Usahawan di Malaysia", pp. 3 - 4. A paper presented at the *Seminar Keusahawanan dan Perniagaan Islam*, Petaling Jaya, Malaysia, 1987. See also Steven T. Abdul Kader, "Strategic Considerations for the Development of *Halāl* Financial Services", in *al-Nahdah*, Vol. VII(1), (Kuala Lumpur, 1987), pp. 34 - 37; M. Ali Baharom, "Kaedah-kaedah *Shari'ah* Dalam *Mu'āmalāt*", A Paper presented at the *Seminar Keusahawanan dan Perniagaan Islam*, 28 - 29 November 1987, Petaling Jaya; Mahmud Saidon, "Teori dan Bentuk-bentuk Kontrak *Mu'āmalāt* Berkaitan Dengan Perbankan", A Paper presented at the *Siri Seminar Ekonomi Islam*, 18 - 19 January 1994, Kuala Lumpur;

⁹⁹ For example, see Sa'id Marṭān, *Madkhal li al-Fikr al-Iqtisādī fī al-Islām*, Muassasat al-Risālah, n. d., pp. 220 - 221; Ahmad al-Najjar, "Islamic Banking : Concept and Implementation", pp. 6 - 7. Paper presented to the *International Conference on Islam and Technology*, Kuala Lumpur, 1983; Muhammad Uzair, "Some Conceptual and Practical Aspects of Interest - Free Banking", in Khurshid Ahmad (ed.), *Studies in Islamic Economics*, Leicester, 1981, pp. 48 - 49; Sobri Salamon, *Bank Islam*, Petaling Jaya, Malaysia, 1984, p. 164; see also Ahmad al-Najjār, *100 Su'āl wa 100 Ajwibah*, Cairo, 1981, pp. 133 - 134.

- (b) savings accounts; and
- (c) investment accounts.

(a) Current accounts

Current accounts are operated in the same way as in the conventional banks. *BIMB* accepts deposits from its customers looking for safe custody of their funds on the *Shari'ah* principles of *wadi'ah* (safekeeping). With the permission of the customers, the Bank uses these funds to generate profit which would entirely belong to the Bank. In return, the Bank provides the customers with the cheque books and other usual current account services. The customers may withdraw a part or the whole of their balance at any time they so desire, and the Bank guarantees the refund of such balances.¹⁰⁰

(b) Savings accounts

BIMB accepts deposits from its customers looking for safe custody of their funds with some degree of convenience in their use together with the possibility of some profits in the form of saving accounts on the principle of *wadi'ah*. The customers may withdraw part or the whole of their balance at any time they desire and the Bank guarantees the refund of such balances. The Bank requests permission from such customers to make use of their funds in any investments so long as these funds

¹⁰⁰ Abdul Halim Ismail (1983a), p.8; *Idem*, (1983b), p. 5; *Idem*, "Cara Melabur di Bank Islam", *Dakwah*, June, 1983, p. 12; *BIMB* (1989), p. 16; Mustafa Hamad, "The Operations of Islamic Banking and Its Implications on Current Accountings Practices", p. 2. A Paper presented at the *Seminar on New Developments in Financing*, Kuala Lumpur, 19 August, 1985; Mustapha Hamat, et al., "Applicability Existing of Accounting Standards for Islamic Banks", *ISLAMIKA*, (Department of Islamic Studies's Journal, University of Malaya, 1991), pp. 250 -251, 255 - 258.

remain with the Bank. However, in contrast with current accounts, the Bank may, at its absolute discretion, reward the customers by returning a part of the profits generated from the use of their funds from time to time.¹⁰¹

(i) Investment accounts

There are two type of investment accounts offered by *BIMB*, both of which are operated on the *mudārabah* principle, i. e. General Investment Account and Special Investment Account.

(i) General investment accounts

Deposits received under this account on the principle of *mudārabah* are invested by the Bank on behalf of the depositors. *BIMB* accepts such deposits on the following basis, i. e. 1 month, 3 months, 6 months, 9 months, 12 months, 15 months, 18 months, 24 months, 36 months, 48 months, 60 months and over. The *mudārabah* contract requires the Bank to act as the "entrepreneur" and the customers as the "providers of capital", and both parties to agree, among others, on how to distribute the profits, if any, generated by the Bank from the investment of the funds. At present, the Bank offers a profit-sharing ratio of 70 : 30 (70 per cent to the customers and 30 per cent to *BIMB* from the gross profits made). This ratio, however, may be varied from time to time so as to maintain an equitable distribution of profits between the two parties. The management of the investment of the funds is entirely under the

¹⁰¹ Abdul Halim Ismail (1983a), pp. 8 - 9; *Idem* (1983b), pp. 8 - 9; *Idem* (1984/85) "Pelaburan Harta Baitulmal melalui Bank Islam dan Syarikat Takaful", p. 3 ; *BIMB* (1989), pp. 16 - 17; Mustapha Hamad, et al (1991), *op. cit.*, pp. 250 - 251; Mustapha Hamad (1985), *op. cit.*, p. 2.

supervision of the Bank. In event of loss, the depositors will bear all the losses.¹⁰²

(ii) Special Investment Accounts

BIMB also selectively accepts deposits from the Government and corporate customers in the form of Special Investment Accounts which are operated on the principle of *muḍārabah*, but the modes of investment of the funds and the ratios of distributions of profits may be individually negotiated.¹⁰³

3.5.2. Project Financing

Two methods used by *BIMB* to finance acceptable projects are governed by the principles of *muḍārabah* and *mushāarakah*.¹⁰⁴

(a) Project financing under the principle of *muḍārabah*

Under this mode of financing, *BIMB* is the "provider of capital" and will provide 100-per cent financing for the relevant project. The initiator of the project is the "entrepreneur" who will manage the project. The Bank cannot interfere in the

¹⁰² *BIMB, Annual Report 1986*, pp. 5-6; *BIMB* (1989), pp. 17 - 18; Abdul Halim Ismail (1992), p. 274; Mustafa Hamad (1985), "The Operation of Islamic Banking and Its Implementations on Current Accounting Practices", p. 2 ; see also Jaafar Ahmad, "Institusi-institusi Kewangan Islam" in Mohd. Nasir bin Omar (ed.), *Tamadun Islam dan Ideologi Masa Kini*, Selangor, 1986, p. 86.

¹⁰³ *BIMB* (1989), pp. 20 - 21; Abdul Halim Ismail (1992), p. 275; see also Abdul Samad bin Haji Alias, et al, *op. cit.*, p. 10.

¹⁰⁴ *BIMB* (1989), pp. 20 - 21; Abdul Halim Ismail (1983a), pp. 10 - 11; *Idem* (1983b), pp. 11 - 12; *Idem*, "Cara Melabur di Bank Islam", *Dakwah*, June, 1983, p. 13; *Idem* (1992), pp. 275 - 276; Mustapha Hamad (1985), "The Operations of Islamic Banking and Its Implications on Current Accountings Practices", pp. 3 - 5.

management of the project, but has the right to undertake the follow-up and supervision tasks. Both parties agree through negotiation on the ratio of distribution of the profits generated from the project, if any. In the event of loss in the project, *BIMB* will bear all the loss.¹⁰⁵

(b) Project financing under the principle of *mushārah*

Under this mode of financing, the Bank together with the initiator or initiators of the relevant project will provide the whole financing for the project in agreed proportions. All parties, including *BIMB*, have the right to participate in the management of the project; but all the parties have the option to waive such right. All parties agree through negotiation on the ratio of distribution of the profits generated from the project, if any. Such a ratio need not coincide with the ratio of participation in the financing of the project. In the event of loss in the project, all parties will bear the loss in proportion to their shares in the financing.¹⁰⁶

(c) Financing the acquisition of assets

BIMB also provides assets financing facilities under various principles such as *murābahah*, *bay' bi thamān ājil* and *ijārah*.¹⁰⁷

¹⁰⁵ *BIMB* (1989), p.20; Abdul Halim Ismail (1983b), p. 11; *Idem* (1992), p. 275.

¹⁰⁶ *BIMB* (1989), pp. 20 - 21; Abdul Halim Ismail (1983b), pp. 11 - 12; Tajuddin Abdul Rahman (1987), "Peranan Bank Islam Dalam Membantu Usahawan di Malaysia", p. 7.

¹⁰⁷ *BIMB* (1989), pp. 21 -23; Abdul Halim Ismail (1983a), pp. 11 - 12; *Idem* (1983b), pp. 12 - 13; *Idem* (1992), pp. 276 - 277; Tajuddin Abdul Rahman (1987), "Peranan Bank Islam Dalam Membantu Usahawan di Malaysia", pp. 8 - 9.

i. **Financing the acquisition of assets under the principle of *murābahah* and *bay' bi thaman ājil* :**

Murābahah

Under this mode of financing, *BIMB* first purchases the asset, movable or immovable, and subsequently sells the relevant asset to the customer at the agreed price which consists of the actual cost of the asset to the Bank plus the Bank's margin of profit.¹⁰⁸

***Bay' bi thaman ājil* (deferred sale)**

Under this mode of financing, *BIMB* first determines the requirements of the customer in relation to the duration and manner of repayment. The Bank then purchases the asset and subsequently sells the relevant asset to the customer at the agreed price which comprises (a) the actual cost of the asset to *BIMB*, and (b) the Bank's margin of profit and allows the customer to settle the payment within a specific period or to pay by instalments or in a manner so determined.¹⁰⁹

ii. **Financing the use of services of assets under the principle of *ijārah* (leasing)**

Financing under the principle of *ijārah* requires *BIMB* first to purchase the asset required by the customer and subsequently to lease the asset to the customer for a fixed period on a rental basis and other terms and conditions as agreed by both

¹⁰⁸ *BIMB* (1989), p. 21.

¹⁰⁹ *Ibid*, pp. 21 - 22; Abdul Halim Ismail (1983a), p. 11.

parties.¹¹⁰

iii. Financing the use of services and subsequent acquisition of assets under the principle of *al-bay' al-ta'jiri* (leasing ending with ownership)

This mode of financing requires *BIMB* to finance its customers who initially wish to acquire the right to use the service of a required asset and subsequently own it. The procedure involved is the same as the above principle of *ijārah*, except that both parties agree that the customer will eventually purchase from the Bank the asset concerned at an agreed price with all the lease rentals previously paid constituting part of the price.¹¹¹

3.5.3. *Qard Hasan* (benevolent loan)

BIMB may use an appropriate proportion of the funds at its disposal in the form of loans to deserving customers under the principle of *qard hasan*. The borrower is obliged to repay only the principal amount of the loan, according to its terms and conditions.¹¹²

¹¹⁰ *BIMB* (1989), p.22.

¹¹¹ *BIMB* (1989), pp.22 - 23; Abdul Halim Ismail (1983a), p. 12; Ahmad Tajuddin Abdul Rahman (1987), "Peranan *Bank Islam* Dalam Membantu Usahawan di Malaysia", p. 11.

¹¹² Abdul Halim Ismail (1992), p. 277; Cf. M. Hamidullah, "A Suggestion for an Interest-free Islamic Monetary Fund", *IR*, (June, 1955), pp. 11- 12;

3.5.4. Trade Finance

BIMB may provide specific facilities or financing, mostly on a short-term basis, for the purpose of facilitating trade or providing working capital for its customers. Such facilities or financing may be granted in connection with the purchase or import and sale or export of goods and machinery, and the acquisition and holding of stocks and inventories, spares and replacements, raw materials, and semi-finished goods. The facilities or financing currently provided include letters of credit, letters of guarantee and working capital under the principles of *wakālah*, *mushārah*, *murābahah*, *ijārah* and *wadī'ah*.¹¹³

Letters of Credit under the principle of *wakālah*

Under the principle of *wakālah* (agency), the customer first informs *BIMB* of his letter of credit requirements and places with the Bank a deposit equal to the full amount of the price of the goods to be purchased or imported which the Bank accepts under the principle of *wadī'ah*. *BIMB* then establishes the Letter of Credit and pays the proceeds to the negotiating bank utilizing the customer's deposit, and subsequently releases the documents to the customers. The Bank charges the customer fees and commissions in connection with this service under the principle of *ijārah*.¹¹⁴

¹¹³ *BIMB* (1989), pp. 24 - 25; See also Abdul Halim Ismail (1983a), pp.13 - 15; *Idem* (1983b), pp. 14 - 15; *Idem* (1992), pp. 278 - 280; Mustapha Hamad (1985), "The Operations of Islamic Banking and Its Implications on Current Accounting Practices", p. 10; Tajuddin Abdul Rahman (1987), "Peranan Bank Islam Dalam Membantu Usahawan di Malaysia", pp. 10 - 14.

¹¹⁴ *BIMB* (1989), p.25.

Letters of Credit under the principle of *mushārah*

This mode of financing requires the customer to inform *BIMB* of his letter of credit requirements and negotiate the terms of *mushārah* financing. The customer places with the Bank a deposit for his share of the cost of the goods to be purchased or imported which the Bank accepts under the principle of *wadī'ah*. The Bank then issues the letter of credit and pays the proceeds to the negotiating bank utilizing the customer's deposit as well as its own share of financing, and subsequently releases the documents to the customer. The customer takes possession of the goods and disposes of them in the manner stipulated in the agreement. Profits derived from the venture will be shared as per agreement.¹¹⁵

Letter of Credit under the principle of *murābahah*

This mode of financing requires the customer to inform *BIMB* of his letter of credit requirements and to request the Bank to purchase or import the goods, indicating thereby that he would be willing to buy the goods from the Bank on their arrival on the principle of *murābahah*. *BIMB* then issues the Letter of Credit and pays the proceeds to the negotiating bank utilizing its own funds. *BIMB* sells the goods to the customer at a price comprising the cost of the goods and a profit margin under the principle of *murābahah* for settlement by cash or on a deferred payment (*bay' bi thaman ājil*) basis.¹¹⁶

¹¹⁵ *Ibid.*, pp. 25 - 26.

¹¹⁶ *Ibid.*, p. 27.

Letter of Guarantee

BIMB may provide the facility of Letter of Guarantee to its customers in certain cases under the principle of *kafālah*. This facility may be provided in respect of the performance of a task, the settlement of a loan, etc. To provide this facility, *BIMB* may require the customer to place a certain amount as a deposit which *BIMB* receives under the principle of *wadī'ah*. *BIMB* will charge the customer fees and commissions in connection with this facility under the principle of *ijārah*.¹¹⁷

Finance for working capital under the principle of *murābahah*

This mode of financing requires the customers to approach *BIMB* to provide financing for his working capital requirements to purchase stocks and inventories, spares and replacements, semi-finished goods and raw materials. *BIMB* first purchases or appoints the customer as its agent to purchase the required goods on its behalf and *BIMB* pays from its own funds. *BIMB* subsequently sells the goods to the customer at an agreed price on the principle of *murābahah*. The customer is allowed to settle this sale price on a deferred term of 30 days, 60 days, 90 days, or any other duration as the case may be.¹¹⁸

3.5.5. Other Services

BIMB also provides other usual banking services under various rules of *Shari'ah*.

¹¹⁷ *Ibid.*, pp. 27 - 28.

¹¹⁸ *Ibid.*, pp. 23 - 24.

Suffice it to mention just a few as follows: remittances and transfers, sale and purchase of foreign currency, investment or portfolio management and trustee and nominee company services.¹¹⁹

Types of financing based on the principles of *Shari'ah* and the modes of contract implemented by *BIMB*¹²⁰ in its operation can be summarised as followed:

Type of Financing	Contracts Used to Grant Financial Facilities
Project Financing	<i>Mudārabah</i> and <i>Mushārah</i> (Equity Financing)
Financing the Acquisition	<i>Murābahah</i> , <i>Bay' bi thaman Ajil</i> (Deferred Sale) of assets, <i>Ijārah wa al-Istiqnā'</i> (Leasing Ending with Ownership) and <i>Qard Ḥasan</i> (Benevolent Loan)
Trade Financing	<i>Wakālah</i> , <i>Murābahah</i> , <i>Mushārah</i> , Letter of guarantee (under the principle of <i>Kafālah</i>)
Services	Fees and Commissions charges under the <i>Shari'ah</i> principle of <i>al-Ajr wa al-'Umūlah</i>

3.6. Examination and Evaluation of the *BIMB*'s Performance

3.6.1. Mobilisation of Monetary Resources

There has been no objection raised against *BIMB* on the use of either *wadi'ah* or *mudārabah* contracts to mobilise deposits among its customers. The mobilisation of deposits by *BIMB* is presented in Table 3.

¹¹⁹ *Ibid.*, p. 28.

¹²⁰ Cf. Ataul Hoque (ed.), *Readings in Islamic Banking*, Dacca, 1987, pp. 131 - 149; M. I. Siddiqi, *Model of an Islamic Bank*, Lahore, 1986, pp. 46 - 66.

Table 3

***BIMB : Customers Deposits (Excluding Short-term Deposits of Institutional Customers),
Depositors and Assets 1983 - 1993, as at 30 June.***

Year	Total Deposits (RM Million)	%**	Total Depositors	Total Assets (RM Million)	%**
1983*	91.1	-	22,499	170.6	-
1984	274.9	201.8	41,086	369.8	116.8
1985	405	47.3	127,980	514.2	39
1986	566.9	40	Not available	682.9	32.8
1987	809.1	43	Not available	932.3	36.5
1988	1,022.2	26.3	200,766	1,153.7	23.7
1989	1,229.2	20.3	235,786	1,368.3	18.6
1990	1,220.9	-0.7	270,049	1,396.3	2
1991	1,175.1	-3.8	299,040	1,357.2	-3.8
1992	1,320.5	12.4	329,990	1,607.8	18.5
1993	1,611.7	22.1	362,111	1,890.6	17.6

Notes: * 1983, as at 31 December.

** Rate of increase (%)

Source : *Bank Negara Malaysia, Annual Report 1984*, p. 75; *BIMB*, Compiled from *BIMB's Annual Reports 1986 - 1993*.

The total deposits mobilised by the *BIMB*, as shown in the Table 3 above, to four types of accounts, namely, current account, saving account, investment and special investment accounts, increased steadily from 1983 to 1989, but with a marginal decrease of growth. The total deposits of the *BIMB* increased from RM 91.1 million in 1983 to RM 274.9 million in 1984, an increase of 201.8 per cent. In 1985, the total deposits continued to increase to RM 405 million, an increase of 47.3 per cent. In 1986, the total deposits further increased to RM 566.9 million but the rate of increase fell from 47.3 per cent in 1985 to 40 per cent in 1986, and increased again in 1987 to RM 809.1 million, an increase of 43 per cent. In 1989, the total deposits

increased to RM 1,229.2 million from RM 1,022.2 million, an increase of 20.3 per cent. Nevertheless, there was a slight decrease in the total deposits of *BIMB* in 1990 and 1991, i.e. RM 1,220.9 million and RM 1,175.1 million respectively. This may be due to the huge dividends offered by other investment institutions especially by the most popular Government backed institutions such as *Tabung Haji*. Total deposits, however, rose again by RM 291.2 million in 1993 to RM 1,611.7, an increase of 22.1 per cent in the financial year.

The total numbers of depositors consisting of individuals, Government Departments, statutory bodies and various entities from the corporate sectors increased steadily from 1983 to 1993. As can be seen from Table 3 above, in ten years of its operations, its depositors increased from 22,499 thousands in 1983 to 362,111 thousands in 1993, an increase of 1509.5 per cent. This can be considered a remarkable progress in terms of the role of *BIMB* in mobilising the funds and savings of the Muslims in particular and Malaysians in general, in a relatively short span of time.

The rates of profits actually paid to the depositors are divided into various accounts based on different weightages. The lowest weightage is given to current accounts and the highest to investment accounts. In the case of investment accounts, different weightage is assigned depending on the time frame, i.e. 1 or 3 or 6 or 9 or 12 or 15 or 18 or 24 or 36 or 48 or 60 months and above. As shown in Table 4 below, the rate of profit to the depositors in the financial years of 1988 to 1993 was between 3.25 and 3.99 per cent per annum for the saving accounts, and for the investment accounts was as follows:

1 month = 3.64 -5.11;

3 months = 3.87 - 5.42;
 6 months = 4.09 - 5.74;
 9 months = 4.32 - 6.06;
 12 months = 4.54 - 6.38;
 15 months = 4.77 - 6.70;
 18 months = 5.00 - 7.02;
 24 months = 5.23 - 7.34;
 36 months = 5.45 - 7.66;
 48 months = 5.68 - 7.98;
 60 months and above = 5.91 - 8.30.

Table 4

BIMB : Rates of profits to depositors (%), as at June 1988 - 1993

	1988	1989	1990	1991	1992	1993
Saving Accounts	3.25	3.31	3.37	3.35	3.65	3.99
Investment Accounts						
1 Month	3.64	3.71	3.78	4.29	4.67	5.11
3 Months	3.87	3.94	4.01	4.55	4.97	5.42
6 Months	4.09	4.17	4.25	4.82	5.26	5.74
9 Months	4.32	4.41	4.49	5.09	5.55	6.06
12 Months	4.54	4.64	4.72	5.36	5.84	6.38
15 Months	4.77	4.87	4.96	5.63	6.13	6.70
18 Months	5.00	5.10	5.19	5.89	6.42	7.02
24 Months	5.23	5.34	5.43	6.16	6.72	7.34
36 Months	5.45	5.57	5.67	6.43	7.01	7.66
48 Months	5.68	5.80	5.90	6.70	7.30	7.98
60 Months and above	5.91	6.03	6.14	6.97	7.59	8.30

Source : Compiled from *Annual Reports of BIMB 1988 - 1993*.

3.6.2. Financing and Investment

The size of banking financing facilities granted to various sectors in the economy is presented in Table 5. The total financing granted by *BIMB* continued to increase yearly but at a declining and fluctuating rate, causing the financing-deposits ratio of the *BIMB* to increase from 44.7 per cent in 1983 to 90.9 per cent in 1984, but fall to 79.5 per cent, 69.7 per cent, 53 per cent, then slightly rise to 59.6 per cent, then fall to 54.2 per cent, then rise again to 66.2 per cent, 67.2 per cent, 76.1 per cent and slightly fell to 61.8 per cent from 1985 to 1993 respectively. The decreasing of this financing-deposits ratios suggests that *BIMB* has a large amount of idle funds not used efficiently. Consequently, this will impose a cost to the Bank as well as affecting its rate of returns.

Table 5

BIMB : Financing of BIMB, 1983 - 1993

Financial Year	Total Deposits (RM Million)	Total Financing of Customers (RM Million)	Ratio of Financing Deposits(%)
1983	91.1	40.7	44.7
1984	274.9	249.8	90.9
1985	405	322	79.5
1986	566.9	395.3	69.7
1987	809.1	428.6	53
1988	1,022.2	609.4	59.6
1989	1,229.2	666.1	54.2
1990	1,220.9	807.8	66.2
1991	1,175.1	789.3	67.2
1992	1,320.5	1,004.7	76.1
1993	1,611.7	996.5	61.8

Source : *Bank Negara Malaysia, Annual Report 1984*, p. 75; Compiled from *Annual Report of BIMB 1986 - 1993*.

If we look at the Bank's modes of operations, we find that heavy reliance has been given to *murābahah* and *bay' bi thaman ājil* contracts. The proportion of funds granted under these two contracts are presented in Table 6. The table shows that the proportion of funds allocated for *murābahah* and *bay' bi thaman ājil* tradings between 1984 to 1993 constituted more than 85 per cent of *BIMB*'s modes of financing. It has continued to increase from 87.3 per cent in 1984 to 95 per cent in 1985, 95.4 in 1986 and 99.2 in 1987. However, it has slightly decreased to 96.9, 94.9 and 84.8 in 1988, 1989 and 1990 respectively. In 1991 nearly 100 per cent of the funds were granted under the *murābahah* and *bay' bi thaman ājil* contracts, and it decreased to 90.7 and 88.7 in 1992 and 1993 respectively.

Table : 6

BIMB : Proportional of Funds' Financing Granted under Bay' Bithaman Ajil and Murābahah, 1984 to 1993

Year	Credit (RM Mil)	BBA (RM Mil.)	%*	MH (RM Mil.)	%*	BBA + MH (%)
1984	249.8	193.9	77.6	24.2	9.7	87.3
1985	357.7	252.5	71.2	84.5	23.8	95
1986	397	338.5	82.3	52	13.1	95.4
1987	525	432.5	82.4	88	16.8	99.2
1988	646	505.5	78.2	121	18.7	96.9
1989	758	579.5	76.4	140	18.5	94.9
1990	865	623.5	72.1	110	12.7	84.8
1991	905	656.3	77.4	118.9	21.9	99.3
1992	1,004.7	723.8	72	188.3	18.7	90.7
1993	996.5	713.5	71	175.9	17.7	88.7

Notes:

* Rate of Financing (%)

BBA = *Bay' bi Thaman Ajil*; MH = *Murābahah*

RM = Ringgit Malaysia

Source : Compiled from *Annual Reports of Bank Negara Malaysia* 1984 - 1992; *BIMB, Annual Report* 1992 - 1993.

These figures show that the funds which were allocated under the other modes of financing such as *muḍārabah* and *mushārah* were very small in percentage. These figures also reflect the Bank's limited scope of operations to merely trading business of acquisition of assets under the modes of *murābahah* and *bay' bi thaman ājil*, thus denying the desire of investors or would-be entrepreneurs to obtain funds for equity based investment in productive business ventures.

It is obvious that the Bank's pattern of financing and investment has a somewhat close resemblance to the practices of other commercial banks. No doubt these two modes of financing will enable the Bank to achieve the normal objectives of commercial banks such as profitability and safety. However, these are rather inconsistent with the proposed involvement of the Islamic bank mainly with the first-line techniques identified such as *muḍārabah* and *mushārah*. Since the *BIMB* is largely engaged in the second-line techniques, that is *murābahah* and *bay' bi thaman ājil*, there are doubts in the minds of the people, as to whether the Bank is allowing interest through the back door.

3.6.3. Profit and Loss Accounts

Table 7

BIMB : Profit and Loss Accounts

Year	Profit before <i>Zakāt</i> and Taxation (in RM Million)
1984	1.2
1985	4.4
1986	3.7
1987	4.5
1988	6.2
1989	10.0
1990	13.4
1991	14.1
1992	16.1
1993	26.9

Source : Compiled from *Annual Reports of BIMB 1984 - 1993*

BIMB was unfortunate to commence operations at the time of recession in Malaysia and this was reflected in the loss incurred in the first year of operation. However, as shown in Table 7, a profit has been recorded in every year since. The initial losses were apparently caused by bad debts on financing. Since then a more cautious approach with tighter internal controls has been operated. Although profitability is modest in terms of the assets employed, the recent growth is an encouraging sign.

3.7. *BIMB* and Economic Development

In terms of significance to the Malaysian economy, *BIMB* is still a relatively small bank compared with other commercial banks. For example, by the end of 1988, *BIMB*'s share of the total banking deposits had risen to 2.3 per cent. Nevertheless, of the twenty-three local banks, *BIMB* ranks thirteenth in terms of both assets and

deposits, tenth in terms of shareholders' funds and fifteenth in terms of profitability.¹²¹ However, this sub-topic will discuss the role and contribution of *BIMB* in the fields of mobilisation of savings and promoting investment, financing projects and social welfare in the country.

3.7.1. Mobilising of Savings and Promoting Investment.

In spite of the fact that only a short time has passed since the *BIMB* experiment began, and in spite of strong competition by interest-banks, the results indicate that *BIMB* has achieved the desired goal as presented in Table 2 above. Its goal is to offer an interest-free banking system to the Muslims in Malaysia and to mobilise their savings in accordance with the *Shari'ah*.¹²² From the above discussion, it can be seen that the role of *BIMB* in encouraging and mobilising the savings of the Malay Muslims is crucial. Prior to the establishment of *Tabung Haji* and *BIMB*, the Malays preferred to hold their wealth in the form of cattle, land and jewellery. In spite of the *fatwā* proposed by the colonial government about the permissibility of accepting interest from the Post Office and Co-operative, the most favoured methods of holding savings were still the traditional ones.¹²³ This attitude was claimed to have been the cause of economic retardation amongst the Malays.¹²⁴

¹²¹ Bank Negara Malaysia, *Annual Report 1988*; Arab-Malaysian Merchant Bank, 1988, p. 3.

¹²² Sobri Salamon, *Bank Islam*, Petaling Jaya, 1984, pp. 117 - 139; *Idem*, "The Ideological Aspects of Islamic Banking", A Paper presented at the *International Conference on Islam and Technology*, Kuala Lumpur, December 1985; "Editor" in *Berita Harian*, 28 April 1993, p. 10; Article, "Bank Islam Buktikan Kemampuan Bersaing" in *Berita Harian*, 2 July, p. 10.

¹²³ F. V. Von der Mehden, *Islam, Development and Politics in Malaysia*, Texas, 1978, p. 8; Cf. Abdul Razak Ayoub, "Bank Moden dan Riba" in *Berita Harian*, 2 July 1988, p. 8.

¹²⁴ *Ibid.*; See also W. Wilder, "Islam, Other Factors and Malays Backwardness : Comments on an Argument" in *Modern Asian Studies*, Vol. II (2), 1968, p. 158; T. G. Lim (ed.), *Reading on Malaysian Economic Development*, Kuala Lumpur, 1975, p. 342.

Therefore, the existence of *BIMB* at least managed to solve the problem of the Malay businessmen having to finance their economic activities by *ribā*-based loans.¹²⁵ Above all, Islamic banking is expected to play an important role in attaining the economic objectives of restructuring the Malay Muslim community which depends on the manufacturing and services sectors and will need the full array of Islamic financial instruments.

3.7.2. Financing Projects.

Table : 8

***BIMB* : Distribution of Financing (%) among the Country's Major Economic Sectors 1987 - 1993**

	1987	1988	1989	1990	1991	1992	1993
1	3.7	5.2	5.2	5.3	5.2	4.0	4.3
2	12.0	19.6	28.4	34.2	30.3	35.4	33.5
3	6.0	1.5	7.2	6.4	8.0	8.3	7.5
4	15.5	11.9	6.8	5.9	6.2	5.8	6.7
5	4.2	5.5	4.5	3.4	3.0	3.0	2.6
6	18.4	3.8	4.1	3.8	4.0	2.0	3.2
7	10.7	25.4	18.7	14.2	10.1	7.1	7.9
8	-	-	-	-	0.7	1.0	-
9	25.6	25.0	25.1	26.8	32.5	29.9	33.0
10	3.9	2.1	-	-	-	3.5	1.3
11	2,484	3,215	4,070	5,029	6,859	12,456	16,711
12	78%	81%	83%	85%	89%	93%	94%

Notes:

1= Agriculture; 2= Manufacturing; 3= Construction

4= Wholesale and Retail Trade; 5= Transport and Storage

6= Business Services; 7= Real Estate; 8= Other Services

¹²⁵ See for example Arifin Salih, "Interest-Free Loan Banking Scheme", in *al-Nahdah*, Vol. XIII(1 - 2), (Kuala Lumpur, 1993), pp. 24 - 25.

9= Miscellaneous including Housing; 10= Others

11= Total Numbers of Account's Financing

12= Per cent of Accounts for amount of less than RM 100,000.00 thousands.

Source : Compiled from **Annual Report of BIMB 1987 - 1993.**

BIMB believes that the success of the economic development process in Malaysia depends mainly on the gradual change towards the creation of a production sector.¹²⁶ For this purpose, *BIMB* grants financing facilities in various economic sectors of the country, particularly those which have an effect on the process of social and economic development such as manufacturing, real estate, agriculture, construction, wholesale and retail trade, transport and storage, housing¹²⁷ and other services. In granting its financing to the above sectors, *BIMB* is largely engaged in small projects with small investors or traders as presented in Table 8. For example, the total number of accounts in customer financing increased to 16,711 from 12,456 previously. Around 94 per cent of these accounts were for amounts of less than RM 100,000.¹²⁸

3.7.3. Social Welfare

As a commercial institution which operates for profit, *BIMB* is also involved in

¹²⁶ Jaffar Hussein, "Facing the Challenge of Islamic Finance" ,in *al-Nahdah*, Vol. VII (4), (Kuala Lumpur, 1987), p. 26; Sobri Salamon, "Bank Islam dan Cabarannya Dalam Pembangunan Ekonomi" in *Ekonomi Islam*, Petaling Jaya, 1989, pp. 194 - 211.

¹²⁷ In participating in housing projects, *BIMB* allocated almost RM 46 million in 1989 for construction projects. It is a policy of *BIMB* to lay emphasis on financing the purchase of low-cost houses by its customers from low and middle-income groups. *BIMB, Annual Report 1989*, p. 35. See also : Sobri Salamon, "Bank Islam dan Cabarannya Dalam Pembangunan Ekonomi", A Paper Presented at the *Seminar Sistem Kredit Islam Dalam Koperasi*, 21 - 22 September 1985, Petaling Jaya.

¹²⁸ *BIMB, Annual Report 1993*, p. 8.

social and welfare activities, for example, the *qarḍ ḥasan* facility which is granted to eligible Muslims who are engaged in viable and productive economic activities. The biggest contribution of *BIMB* in the field of social welfare is through its annual *zakāt* payment from its profits. *Zakāt* is an obligatory levy on all surplus wealth and agricultural income of Muslims. Its objective is to provide financial support to specified categories of people such as the poor and the needy.¹²⁹ Conceptually, *zakāt* is supposed to be a milestone in providing social security, eradicating poverty and stimulating the economy.¹³⁰ As Table 9 shows below, *zakāt* paid by *BIMB* increased every year. For example, *zakāt* paid by *BIMB* in 1993 amounted to RM 662,000 and this amount can be channelled to promote economic development of Muslims in Malaysia.

Table 9

BIMB : Zakāt Payment, 1985 - 1993

Year	Zakāt (in RM '000)
1985	415
1986	377
1987	381
1988	358
1989	467
1990	449
1991	663
1992	662
1993	662

Source : Compiled from Annual Reports of *BIMB* 1985 - 1993.

¹²⁹ Aghnides, *Mohammedan Theories of Finance*, New York, 1916, pp. 203 - 347.

¹³⁰ F. R. Faridi, "Zakāt and Fiscal Policy", in Khurshid Ahmad (ed.), *Studies in Islamic Economics*, Leicester, 1981, pp. 119 - 130; Monzer Kahf, *The Islamic Economy*, Indiana, 1978, pp. 59 - 67; A. H. M. Sadeq, *Economic Development in Islam*, Petaling Jaya, 1990; Ataul Huq, *Development and Distribution in Islam*, Petaling Jaya, 1993, pp. 35 - 41.

3.8. *BIMB* : Problems and Challenges

3.8.1. Legal Impediments to Islamic Banking

Islamic law relating to commerce and business (*mu'āmalāt*) in Malaysia is only applicable to a very limited scope, since the law relating to this matter is either the statute law or English law. In this connection, Section 5 of the *Civil Law Act 1956* provides that "in the absence of any written law, the law generally applicable to commercial matters and any matters incidental thereto is the English Law". In other words, English law principles are inapplicable if there are other provisions in any law covering the question or issues which have been decided. If, however, there is no provision dealing with the issue in question, though there may be a general act covering certain aspects of the law, the issue shall be settled by reference to English law on the matter not covered by the Act.¹³¹ Even though the *IBA 1983* and others were enacted, they were merely acts to provide for the licensing and regulating Islamic commercial institutions and did not include any provision of the substantive law.

For this reason, Islamic financial institutions have to work in the context of the Islamic contracts such as *murābahah*, *bay' bi thaman ājil*, *ijārah*, etc, which have to be interpreted in line with the equivalent of the relevant legislation and the English principles applicable to interpret or supplement the legislation.¹³² In the case of *BIMB*

¹³¹ Section 5, *Civil Law Act, 1956*.

¹³² Ahmad Ibrahim, "Legal Aspects of the Establishment of the Islamic Law", pp. 3 - 13; Idem, "The *Sharī'ah* and Codification : Malaysia Experience", pp. 59 - 60; Mustapha Hamat, "Pembiayaan dan Penyediaan Modal Menurut Islam", in *Dunia Islam*, (Kuala Lumpur, January 1992), p. 51 - 53; Nik Mustapha Nik Hassan (1989), "Pendekatan Sistem Ekonomi Islam Dalam Meningkatkan dan Memajukan

v. **Tinta Press Sdn. Bhd.** (1986 MLJ 256; 1987 CLJ 474), a dispute relating to lease (*ijārah*) of printing equipment by *BIMB* to the defendants had to be dealt with in the High Court according to English legal principles. The question arises whether such legislation and legal principles are in line with the *Shari'ah*. The relevant legislation already existing includes *Contract Act, 1950, Bankruptcy Act, 1967, Companies Act, 1965, Partnership Act, 1961* and *Sale of Goods (Malay States) Ordinance, 1957*. There is an urgent need to examine these statutes and to bring them into line with the requirement of the *Shari'ah*, or to make them inapplicable to Muslims.¹³³

There are some other legal hindrances to the smooth running of Islamic banking in Malaysia vis-a-vis customer financing. These include:

National Land Code (NLC) 1965

Section 205(3) of the *National Land Code 1965*¹³⁴ which prohibits the transfer of an undivided share of agricultural land of less than 2/5 hectare (1 acre) has created a disadvantage for *BIMB*. The reason is that the nature of the operation of *BIMB* involves buying the property on behalf of customers, and not merely being an intermediate agent between the buyer and the seller as practised by conventional

Kedudukan Ekonomi Masyarakat Melayu", pp. 13 - 14; Fokus, "Kerajaan Bertanggungjawab Melaksanakan Sistem Ekonomi Islam", in *Dunia Islam*, (Kuala Lumpur, November 1991), pp. 20 - 26.

¹³³ Ahmad Ibrahim, "Legal Impediments in the Islamisation of the Malaysian Economy with Special Reference to Banking and Insurance", A paper presented at the *Seminar on Issues in Islamic Economics*, 29 December, 1985, Petaling Jaya, Malaysia; Syed Othman Alhabshi, "Dasar Kerajaan", in S. G. S. Abod, et al (eds.), *Pengurusan Perniagaan Islam*, Shah Alam, 1991, pp. 391 - 400.

¹³⁴ Section 205(3) of the *National Land Code 1965* provides that, "subject to sub-section (4), no dealing in respect of any alienated land or any interest therein subject to the category 'agriculture' or to any condition requiring its use for any agricultural purpose shall be effected if such dealing would have the effect of creating any undivided share of such size that, if the land is to be partitioned in proportion to the several shares, the area of any resulting individual portion would be less than two-fifths of a hectare".

banks. For example, if there is a piece of land belonging to A and B and the customers C and D go to *BIMB* to ask the latter to finance the buying of the said property and *BIMB* buys the property and it will have difficulty if it is going to sell the property to C and D because the provision of the *National Land Code 1965* prohibits the transfer of that land to another party. Therefore, this provision should be abolished or made inapplicable to *BIMB* since unlike other commercial banks, it is involved in trade, not merely in financing transactions.

Hire Purchase Act, 1967

BIMB is presently involved in financing its customers in acquiring fixed assets such as land, property, equipment, etc under the principles of *bay' bi thaman ājil*. Nevertheless this Islamic contract of *bay' bi thaman ājil* is not covered by the *Hire Purchase Act, 1967* since the Act is outside the principle of the *Shari'ah*. According to the *Shari'ah*, there should not be two transactions in one contract (*'aqd*). It must be two separate transactions, i. e. hire followed by purchase.

The *Hire Purchase Act* has given complete protection both to the financier and the debtor in terms of legal documentation and enforcement of such an agreement. Thus, it will not be difficult for a financial institution to conduct its operations especially in cases involving repossession, unlike the agreements entered into under *bay' bi thaman ājil* which need approval from a Civil Court before they can be enforced. Therefore, it is hoped that this Act can be modified in order to make it consistent with the *Shari'ah*.

3.8.2. Islamic Banking in a Capitalistic World

The theoretical concept of Islamic banking on the basis of profit and loss sharing was originally developed under the explicit assumption of a general prohibition of interest.¹³⁵ Today, *BIMB* has to carry on its business in a capitalist economy where interest persists and *BIMB* exists side by side with interest-based banks. This phenomenon will create problems for a newly established Islamic bank in competing with the established and widespread influence of the conventional banks.

Normally, depositors in Islamic banks can be classified into two categories:

- a. Those motivated mainly by Islamic commitment and conviction regarding the prohibition of interest. These depositors will put their money in an Islamic bank regardless of the rate of interest as it is the only institution devoid of interest.
- b. Those who are concerned purely with maximisation of profits.

¹³⁵ For a discussion see M. A. Mannan, "Islam and Trends in Modern Banking" in *The IR*, Vol. LVI (11-12), 1968, pp. 5 - 10; Vol. LVII (1), 1969, pp. 28 - 33. These articles also published in *al-Islam*, Vol. III (3), 1972, pp. 1 - 16; Sh. Mahmud Ahmad, "Banking in Islam" in *al-Islam*, Vol. III (2), 1972, pp. 37 - 46; M. N. Siddiqi, "Banking in an Islamic Framework" in *Islam and Modern Age*, Vol. VIII (4), 1977, pp. 4 - 20; Muhammad Sami'ullah, "Elimination of Interest from the Economy" in *Islamic Order*, Vol. VI (1), 1984, pp. 103 - 114; Waqar Masood Khan (1985), *Towards an Interest-Free Islamic Economic System*, pp. 23 - 52; Mohsin S. Khan and Abbas Mirakhor (1986), pp. 33; *Idem*, "The Financial System and Monetary Policy in an Islamic Economy" in Mohsin S. Khan, et al (eds.), *Theoretical Studies in Islamic Banking and Finance*, pp. 163 - 184; T. W. Taylor and J. W. Evans, "Islamic Banking and the Prohibition of Usury in Western Economic Thought" in *National Westminster Bank Quarterly Review*, November 1987, pp. 21 - 27; Muhammad Anwar (1987), *Modelling Interest-Free Economy : A Study in Macro-Economics and Development*, 84pp.; Zubayr Iqbal and Abbas Mirakhor, "Islamic Banking", pp. 91 - 94; . A. Saud, "Toward Islamic Economics" in *Toward Islamization of Disciplines*, Herndon, Virginia, U. S. A., 1989, pp. 265 - 270; R. Wilson, "Economic Change and Re-Interpretation of Islamic Social Values", in *British Society for Middle Eastern Studies Bulletin*, Vol. IX (1), 1982, pp. 108 - 111; W. M. Ballantyne, *Commercial Law in the Arab Middle East : The Gulf States*, London, 1986, 122 - 125; John Thomas Cummings, et al, "Islam and Modern Change", in John L. Esposito (ed.), *Islam and Development : Religion and Sociopolitical Change*, New York, 1980, pp. 32 - 34; A. L. Udovitch, "Bankers Without Banks : Commerce, Banking, and Society in the Islamic World of the Middle Ages", in the Center for Medieval and Renaissance Studies, University of California (ed.), *The Dawn of Modern Banking*, New Haven and London, 1979, pp. 256 - 273.

An entrepreneur who is concerned with the maximisation of profits in an investment project will only decide in favour of an Islamic bank on the basis of a profit and loss sharing contract, if the expected profit is higher than that of interest from conventional banks. Since both the entrepreneur and the Islamic bank strive for maximum profit, they will bargain for the desired predetermined ratio of their profits. If an Islamic bank claims a higher ratio of profit than the entrepreneur, this will lead the latter turns to a conventional bank. Therefore, the Islamic bank has to adapt its claims for a given investment project to the market rate of interest. Therefore, if the interest rate of commercial banks is high, *BIMB* cannot claim a higher ratio of profit sharing since it will be less attractive to customers who have the option of investing in an interest-based banks.¹³⁶

Furthermore, in the capitalistic environment of Malaysia, where an Islamic and conventional banks co-exist, customers may only deposit or invest their money in *BIMB*'s general investment or special investment accounts if they are confident that they will gain higher profits and their money is secure. This can be seen, for example, in the financial year of 1991 and 1992,¹³⁷ *BIMB*'s total deposits from customers rose but the balances in general investment accounts continued to decrease as its rates of profit were less attractive against rates of interest on fixed deposits paid by the conventional banks.¹³⁸ In addition, *BIMB* is competing not only with the commercial banks, but also with other Government supported investment institutions

¹³⁶ Barjoiyi Bardai, "Jurang Harapan Pelabur Bank Islam" *Berita Minggu*, 2 January 1994, p. 8; Interview with Tajuddin Abdul Rahman, Managing Director of *BIMB*, Kuala Lumpur, 24/11/94.

¹³⁷ See Chapter III, 3.6.1, Table 3, p. 176.

¹³⁸ *BIMB, Annual Report 1991*, p. 6; 1992, p. 5; Z. Phoon, "Jaafar's Dream : The Islamic Banking is available to all *Bumiputeras*, Non-*Bumiputeras*, Muslims and Non-Muslims" in Kuala Lumpur Stock Exchange, *Investors Digest*, April, 1993, p. 13.

such as *Tabung haji*. In this case, *Tabung Haji* has managed to offer an attractive rate of return (dividend) to its depositors.

3.8.3. Over-Dependence on "Second-Line Techniques"

Another issue raising concerns is the excessive reliance of the *BIMB* on the second-line techniques of operation, that is *murābahah* and *bay' bi thaman ājil* since the early days of its inception. These secondary techniques are seen by some scholars as counterparts to the institution of interest as practised by conventional banks. This is because the mark-ups charged by the *BIMB* are about the same as the rate of interest, if we were to convert these mark-ups into a ratio of the principal sum of money provided by the bank. Therefore they accuse *BIMB* of charging interest in "a disguised form" and being "mainly similar to other commercial banks albeit without the interest label".¹³⁹ Consequently, the cost of finance advanced by *BIMB* under the above methods is still high and is comparable to the cost of funds provided by other banks based on interest.

Although *murābahah* and *bay' bi thaman ājil* are technically correct and permissible in the *Shari'ah*, in effect they operate very much like interest-based lending. Moreover, they are considered as weaker Islamically speaking because of

¹³⁹ For example, see Zakariya Man (1988), "Islamic Banking : The Malaysian Experience" p. 91; Janne Conners, "Towards a System of Islamic Finance in Malaysia", in *Islamic Law and Finance*, p. 11; Naziruddin Abdullah, "Bank Islam : Fungsi, Operasi dan Masa Depan", Mimeo, International Islamic University, Malaysia, pp. 18 - 24; Nik Mustapha N. Hassan, "Institusi Ekonomi Islam di Malaysia : Suatu Persoalan Tentang Keberkesanannya", Paper presented at the *Simposium Keilmuan Islam*, 25 January 1987, Kuala Lumpur.

their minimal risk and pre-determined fixed rate of return in the business.¹⁴⁰ Siddiqi for example is disturbed at this phenomenon: "There is a genuine concern among Islamic scholars that if interest is largely substituted by devices like 'mark-up', it would represent a change just in number rather than in substance, and the new system would not be rid of iniquitous nature of the interest-based system".¹⁴¹

The Bank has been accused of being only concerned with making profits and neglecting the welfare element in its operations.¹⁴² According to officials of *BIMB* in a series of lectures, this allegation was due to the tendency of the people to equate *BIMB* with the *bayt al-māl* (welfare institution).¹⁴³ However, they say that *BIMB* belongs to the *tijārī* (commercial) sector. As a commercial organisation, it is argued that *BIMB* operates on profit because it needs to protect the interests of the depositors

¹⁴⁰ Muhammad Umar Chapra (1986), *Towards a Just Monetary System*, pp. 163 - 174; *Idem*, "Towards an Islamic Financial System" in Abul Hasan M. Sadeq, et al (eds.), *Development and Finance in Islam*, Petaling Jaya, Malaysia, 1991, pp. p. 138 - 139; Ziauddin Ahmed, "Islamic Banking at the Crossroads" in Abul Hasan M. Sadeq, et al (eds.), *Ibid*, pp. 157 - 170; Muhammad Nejatullah Siddiqi, *Issues in Islamic Banking*, Leicester, U. K., 1983. 134 - 143; *Idem*, "Islamic Banking : Theory and Practice" in Mohamed Ariff (ed.), *Islamic Banking in Southeast Asia*, Singapore, 1988, pp. 51 - 57.

¹⁴¹ M. N. Siddiqi, "Islamic Banking : Theory and Practice" in Mohamed Ariff (ed.) (1988), *op. cit.*, p. 56. He goes further to say: "It is also emphasised that, apart from equity consideration, the prohibition of interest in Islam is meant to stimulate overall productive activity, generate maximum employment and encourage innovation which is the mainspring of growth. These blessings can only be reaped if the interest system is completely uprooted in the real sense of the term and replaced by a fundamentally different system like profit/loss sharing". *Ibid*.

¹⁴² For example, see Mohd. Azmi Omar, "Bank Islam dan Matlamatnya", pp. 31 - 35. A Paper presented at the *Seminar Kursus Ekonomi Islam*, Sintok, Kedah, 1987; Nik Mustafa Nik Hassan, "Institusi Ekonomi Islam di Malaysia : Suatu Persoalan Tentang Keberkesanannya", pp. 29 - 30. A Paper presented at the *Simposium Keilmuan Islam*, University Malaya, 1987; Mohammad Ariff, "Islamic Banking in Malaysia : Framework, Performance and Lessons", *Journal of Islamic Economics*, (Petaling Jaya, 1991), p. 76; Barjoyai Bardai (1994), *op cit.*, p. 8; *Cf.* Malami, "Prospects of Islamic Banking in the Muslim Minority Communities", *JIMMA*, Vol. XIII (2), 1992, pp. 309 - 310.

¹⁴³ Muslim Scholars have categorised the Islamic economic system into three sectors: a. *siyāsī* or government sector which should encompass all public sector commercial activities; b. *tijārī* or commercial sector which should encompass all private sector commercial activities; and c. *ijtimā'ī* or welfare sector which should encompass the administration of *bayt al-māl*, *zakāt* and *ṣadaqah*.

and shareholders by maintaining a reasonable rate of return on their investment.¹⁴⁴

The nature and aim of *BIMB* to make profits in its business by using the second line techniques has been criticised by some scholars.¹⁴⁵ They strongly argue that *BIMB* should concentrate on *muḍārabah* and *mushārah* in its operations which are claimed to be more just and in line with Islamic principles. In this connection, Zakariya Man says:

The fact that the bank needs to make profits cannot justify its over-dependence on the second line techniques of operation because possibilities for making even more profits through the first line techniques such as *muḍārabah* and *mushārah* are not absent. Besides, the Bank's over dependence on the second line techniques may also lead to inequitable distribution of gains between the users and the providers of capital. Otherwise, the Bank cannot contribute significant changes in the distribution of income as encouraged by Islam. In this context, it is relevant to note that many customers of the bank prefer to get *murābahah* rather than *mushārah* finance, as they make more profits after paying a fixed sum of mark-ups as agreed in the contract. Clearly, the first-line techniques of *muḍārabah* and *mushārah* will be more just in terms of profit distribution between the users and the providers of capital.¹⁴⁶

There are several arguments which support the *BIMB* stance, some of which¹⁴⁷ are:

¹⁴⁴ See Abdul Halim Ismail, "Bank Islam : Prospek dan Perkembangannya Pada Masa Hadapan"; *Idem*, "Islamic Banking in Malaysia : Some Issues, Problems and prospects", pp. 1 - 13. A Paper Presented at the *Seminar on Issues in Islamic Economics*, 27 - 29 December 1985, Petaling Jaya, Malaysia; *Idem*, "Sistem Kewangan Islam Dengan Tumpuan Kepada Urusan Bank dan Insuran", pp. 7 - 11. A Paper presented at the *Seminar Shari'ah Islam*, 6 - 9 September 1986, Brunei Darulsalam, also presented at the *Bengkel Tertutup Pemikiran Sistem Ekonomi Islam Berasaskan Shari'ah Peringkat Kebangsaan*, 21 March 1989, Kuala Lumpur; *Idem*, "Aspects of the Islamic Economics System and Its Treatment in the Issue of Poverty", pp. 13 pp. 13 - 16. A Paper Presented at the *International Seminar on Islamic Philosophy and Science*, 30 May - 2 June, 1989, Pulau Pinang, Malaysia; *Arabia*, Vol. V (56), 1986, p. 68; Barjoyai Bardai (1994), *op cit.*, p. 8.

¹⁴⁵ See ref. no. 141, above.

¹⁴⁶ Zakariya Man (1988), p. 92.

¹⁴⁷ Interview with Tajuddin Abdul Rahman, Managing Director of *BIMB*, Kuala Lumpur, 24/11/94.

- a. There is no *Qur'ānic* prohibition on these types of finance. Therefore, to equate the practice of trade financing under the scheme of *bay' bi thaman ājil* and *murābahah* with interest amounts to rejecting the permissibility of trade as expounded by the *Qur'ān* and the rulings of Muslim jurists.¹⁴⁸ Moreover, *BIMB* has a *Shari'ah* Advisory Council to oversee the Islamic validity of its operations and therefore it should have advised *BIMB* if these methods were *ḥarām*.¹⁴⁹
- b. The requirement of the members of the community in this modern age are highly varied. There are various types of financing required by customers for such purposes as house purchase or business. These various modes of financing would have to be met to the satisfaction of both financier and the party financed.¹⁵⁰ To restrict all the requirements to or give priority to the profit and loss sharing transactions would have the effect of undermining the criteria of meeting the viability of both parties, i. e. the Bank and the customers.¹⁵¹

¹⁴⁸ Abdul Halim Ismail, "The Deferred Contracts of Exchange : Al-Qur'ān in Contrast with the Islamic Economists' Theory on Banking and Finance", pp. 6 - 51. A Paper Presented at the *Bengkel Tertutup Pemikiran Sistem Ekonomi Islam Berasaskan Shari'ah Peringkat Kebangsaan*, 21 March 1989, Kuala Lumpur; *Idem*, "Shari'ah and the Islamic Economics : Permissibility of Uses of Funds Contracts", pp. 1 - 11, *Ibid*; *Idem*, "The Deferred Contracts of Exchange in al-Qur'ān" in Sheikh Ghazali Sheikh Abod, et al(eds.), *An Introduction to Islamic Finance*, Kuala Lumpur, 1992, pp. 284 - 313; Article, "Bank Islam (M) Berhad : Operasi, Masalah dan Masa depan" in *Risalah*, Vol. XIV, Petaling Jaya, Malaysia, 1990, p. 19; Jaffar Hussein, "Islamic Financial System in the 1990s", in *NAH*, Vol. X(1 - 2), (Kuala Lumpur, 1990), pp. 13 - 14.

¹⁴⁹ Abdul Halim Ismail, "Sistem Kewangan Islam Dengan Tumpuan Kepada Urusan Bank dan Insuran", pp. 15 - 19; *Idem*, "The Deferred Contracts of Exchange : Al-Qur'ān in Contrast with the Islamic economists' Theory on Banking and Finance", pp. 51 - 52.

¹⁵⁰ Abdul Halim Ismail (1992a), pp. 261 - 262.

¹⁵¹ Ahmad Tajuddin Abdul Rahman (1987), pp. 19 - 20; A. Halim Ismail (1985), "Bank Islam : Prospek dan Perkembangannya Pada Masa Hadapan", pp. 19 - 20; Article, "Bank Islam (M) Berhad : Operasi, Masalah dan Masa Depan", in *Risalah* (1990), p. 20.

- c. Such methods are considered less risky in view of the capitalist climate of Malaysia. The possibility of getting an unscrupulous partner in such profit and loss sharing contracts might cause loss to *BIMB*. Further, *BIMB* has to monitor the project and more personnel have to be employed.¹⁵²

The resolution over the debate concerning the first and second line techniques of operations is fundamental to the continued success of Islamic banking in Malaysia. There exists a real danger that an element of doubt may exist in the minds of depositors that *BIMB* is failing to be a truly Islamic bank.¹⁵³

3.9. The future of Islamic Banking in Malaysia

Islamic banking is widely recognised by Muslim scholars as one of the approaches to be adopted in the process of Islamising an economy. This approach is based on the premise that under the existing political, social and technical constraints, Islamization should be phased in, so as to avoid any abrupt changes which might cause unpredictable chaos in the economy. Accordingly, Islamization of the banking sector is to be implemented by first establishing the model of an Islamic bank side

¹⁵² A. Halim Ismail (1985), "Bank Islam : Prospek dan Perkembangannya Pada Masa Hadapan", p. 8; A. Tajuddin Abdul Rahman (1987), p. 17; Interview: Tajuddin Abdul Rahman, Managing Director of *BIMB*, Kuala Lumpur, 24/11/94.

¹⁵³ C. Muzaffar in his works, *Islamic Resurgence in Malaysia*, Petaling Jaya, Malaysia, 1987, p.82 writes that the Islamic Bank is but another bank. It may abolish interest, but given the capitalist structure of the economy, the bank like other commercial banks, will continue to mobilise the savings of the ordinary people for investments that will earn profits, which will almost always benefit those in the middle and upper echelons of society. The abolition of interest in a capitalist economy without other fundamental changes can only lead to greater injustice and inequities.

by side with the existing interest-based banks.¹⁵⁴ The nature of co-existence between Islamic and conventional banking is going to be a significant issue for the Malaysian economy. In this regard, Tan Sri Jaafer Hussein, the former Governor of the Central Bank of Malaysia said: "I have a dream, and my dream is that I will be able to see, in my life time, a fully fledged Islamic financial system in Malaysia side by side with the existing conventional system, both equally sophisticated and modern".¹⁵⁵

He also said :

Our aim during the 1990s is to establish a comprehensive financial system which runs parallel with the conventional system. We should not aim at least for the present to completely replace the conventional system in Malaysia with the Islamic financial system. The Islamic financial system should be implemented gradually, so as not to create disruptions. This is important considering that Malaysia has a multi-religious population.¹⁵⁶

Dr. Halim Ismail, the former Managing Director of *BIMB* and the initiator of Islamic banking in Malaysia had been interviewed on the possibility of the Islamization of banking in Malaysia. He did not believe in universal Islamization,

¹⁵⁴ See for example, M. Umer Chapra 1986), pp.228 - 231; *Idem* (1991), "Towards an Islamic Financial System", p. 139; Khurshid Ahmad, "Islamic Approach to Banking : Some Conceptual and Operational Aspects". Paper Presented at the *International Conference on Islam and Technology*, Kuala Lumpur, December 1985, 9pp; Omar Asghar Khan, "Political and Economic Aspects of Islamisation", in O. A. Khan (ed.), *Islam, Politics and the State*, Kuala Lumpur, 1987, pp. 77 - 98; Z. Ahmed, "Islamisation of Financial System", *JIBF*, Vol. XI (2), 1994, pp. 22 -30; For the Malaysian perspective, see Hamzah Ismail and Ahmad Shahbari Salamon, "Ke Arah Perlaksanaan Sistem Ekonomi Islam di Malaysia" in Mahayudin Hj. Yahaya (ed.), *Islam dan Pembangunan Negara*, Bangi, Selangor, Malaysia, 1986, pp. 124 - 142; A. H. Pramanik, *Development and Distribution in Islam*, Petaling Jaya, 1993, pp. 108 - 109; Mustafa Hamat, "Pelaksanaan Sistem Kewangan Islam Ke Atas Institusi Kewangan Islam Kini", in *Dunia Islam*, (Kuala Lumpur, February 1991), pp. 53 - 54. See also CII Report pp. 128 - 129. Cf. The Report of the Council of Islamic Ideology of Pakistan on the Elimination of Interest, which is a product of the combined efforts of the experts in economics and banking and those of *Sharī'ah* has been internationally acclaimed as a historic document on the subject. *CII Report*, pp. 103 - 257; M. A. Khan, "Islamic Banking in Pakistan" in *International Journal of Islamic and Arabic Studies*, Vol. II (2), 1985, p. 21.

¹⁵⁵ Quoted in *The Star*, 4 November 1991, p. 1; Datuk Mustapa Mohammad, who was the Deputy Finance Minister also stressed the policy that the conventional banking system was not going to be abolished or replaced totally with the Islamic financial system. Quoted in *Berita Harian*, 12 April 1994, p. 11.

¹⁵⁶ Quoted in *Berita Harian*, 30 march 1990.

rather he upheld the system of co-existence which he claimed to be more suitable to multi-racial Malaysia.¹⁵⁷

BIMB remains the sole Islamic bank in Malaysia, surrounded by hundreds of conventional banks. As mentioned earlier, in 1982 the former Finance Minister said that the Islamic Bank was "a first in the Government's efforts to instil Islamic values into the country's economic and financial system as a "replacement for the current Western-based economic system". He further added that "in the near future, there would be as many as 100 such banks throughout the country".¹⁵⁸

BIMB is still monopolising the Islamic banking sector in Malaysia and Muslims have no choice but to turn to this bank to avoid involving themselves in *ribā* transactions. However, *BIMB* has, in many instances, been criticised for imposing a higher rate of mark-up in financing their customers as compared to interest-based banks. For the critics, this is tantamount to exploitation which is equally forbidden in Islam.

Instead of establishing more Islamic banks, the Malaysian Government has recently embarked upon establishing interest-free banking facilities within existing conventional banks. The pilot scheme which was launched by the Finance Minister, Datuk Seri Anwar Ibrahim on 4 March 1993¹⁵⁹ involving three major commercial

¹⁵⁷ Abdul Halim Ismail, "Should the Whole Banking be Islamised?" in *the Muslim Reader*, Singapore, 1989, p. 13. See also Aidit Ghazali, *Development : An Islamic Perspective*, 1990, pp. 129 - 135.

¹⁵⁸ Quoted in H. Mutalib (1990), *op. cit.*, p. 138.

¹⁵⁹ "Editor" in *Berita Minggu*, 7 March, 1993, p. 10; See also Article, "Perkhidmatan Bank Tanpa Faedah", in *Al-Islam*, (Kuala Lumpur, April, 1993), p. 7.

banks in Malaysia, i. e. Malayan Banking Berhad (MBB), Bank Bumiputera Malaysia Berhad (BBMB) and United Malayan Banking Corporation (UMBC) was to provide a wider application for Islamic banking activities and to help refine the domestic banking sector into a sophisticated and mature industry. They were given permission to offer interest-free banking facilities to customers side by side with their conventional banking. These facilities, which include customers' deposit accounts, assets financing and trade financing, are based on the *Shari'ah* principles such as *wadi'ah*, *muḍārabah*, *murābahah*, *bay' bi thaman ājil*, *ijārah*, *kafālah* and *wakālah*¹⁶⁰ as presented in Table 10 below.

The three banks which form the first phase of the Interest-Free Banking Services provide these services through their 281 branches throughout the country. These facilities have met with an encouraging response from the public. In less than 2 months, their operations have attracted almost RM 30 million in public deposits and investments involving a total of 4,146 depositors. Of the total amounts, RM 5,598 million was placed in saving accounts by 3,853 account holders, and the rest in investment deposit accounts by 293 depositors.¹⁶¹

Interest-Free Banking is another way of mobilising funds for productive purposes

¹⁶⁰ Azhar Abu Samah, "Bank Tanpa Riba Dapat Sambutan" in *Berita Harian*, 12 March 1993, pp. 1-2; Abdul Monir Yaacob, "Mempraktikkan Institusi Kewangan Islam" in *Berita Harian*, 24 September 1993, p. 10; *Berita Minggu*, 24 April, 1994, p. 11; Dinsman, "Menerokai Sistem Kewangan Yang Adil" in *Dewan Masyarakat*, January 1994, pp. 6 - 8; Article, "Perkhidmatan Bank Tanpa Faedah", in *Al-Islam*, (Kuala Lumpur, April 1993), p. 7; Dinsman, "SPTF Bukan Saingan Sistem *Ribā*?", in *Dewan Masyarakat*, (Kuala Lumpur, Mac 1994), pp. 11 - 12; Cf, Mahsin Mansor, *Undang-undang Perdagangan Dalam Islam*, Kuala Lumpur, 1984.

¹⁶¹ Azhar Abu Samah, "Bank Tanpa Riba Dapat Sambutan" in *Berita Harian*, 12 March, 1993, p. 1; Noor Hayati, "Interest-Free Banking Gets Good Response" in *New Straits Times*, 28 April, 1993, p. 2;

and national development from Malaysians in general and Muslims in particular.¹⁶² It also offers the public and the corporate sector an alternative way of investment. Under this system, the bank shares the profit earned from the utilisation of deposits, including a share in the profits gained from the bank's investment in the clients' projects. The return to the depositors, the bank and the users of the funds would depend on the profit and the pre-determined profit and loss-sharing ratios.¹⁶³

Table 10

Products of The Interest Free Banking Scheme¹⁶⁴

Products	Principles
A) Customers' Deposits 1. Savings Accounts 2. Current Accounts 3. General Investment Accounts	<i>Wadī'ah</i> <i>Wadī'ah</i> <i>Mudārabah</i>
B) Assets Financing 4. Financing the Acquisition of Assets such as houses and vehicle	<i>Murābahah</i> or <i>Bay' Bi thaman Ājil</i> or <i>Ijārah</i>
C) Trade Financing 5. Interest-Free Accepted Bills 5.1. Import/purchase 5.2. Export/sale 6. Interest-Free Export Credit Refinancing 6.1. Pre-delivery 6.2. Post-delivery 7. Interest-Free Bank Guarantee 8. Interest-Free Shipping Guarantee 9. Letter of Credit 10. Letter of Guarantee	<i>Murābahah</i> or <i>Bay' al-Dayn</i> <i>Bay' al-Dayn</i> <i>Murābahah</i> or <i>Bay' al-Dayn</i> <i>Bay' al-Dayn</i> <i>Kafālah</i> <i>Kafālah</i> <i>Wakālah</i> or <i>Murābahah</i> or <i>Mushārah</i> <i>Kafālah</i> or <i>Ijārah</i>

¹⁶² "SPTF Terbuka Kepada Semua Kaum", in *Dewan Ekonomi*, (Kuala Lumpur, January 1994), p. 43; Cf. Shaifuddin Aliman, "Sistem Perbankan Islam", in *Ibid*, pp. 41 - 42.

¹⁶³ A. Rachel, "Islamic Banking Gains Popularity" in *New Sunday Times*, 10 October, 1993, p. 26; Dzulfajstri Abdul Razak and S. I. Abdul Karim, "Skim Perbankan Tanpa Faedah", in *Dewan Ekonomi*, (Kuala Lumpur, May 1994), pp. 8 - 9.

¹⁶⁴ See, for example, "SPTF Alternatif Kepada Sistem Konvensional" in *Dewan Ekonomi*, Mei, 1994, pp. 10 - 12; Azhar Abu Samah, "Bank Tanpa Riba Dapat Sambutan" in *Berita Harian*, 2 Mac 1993, p. 1; Idem, "SPTF Beri Pilihan Luas Kepada Pelanggan" in *Berita Harian*, 7 Oktober 1994, p. 4; A. Rachel, *op. cit.*, p. 26; Mohamed Sidek Ahmad, "Banking on Interest Free Principles" in Kuala Lumpur Stock Exchange, *Investors Digest*, October 1993, pp. 31 - 33.

Ten more financial institutions are involved in the second phase of the Interest-Free Banking scheme, which was launched by the Finance Minister on 21 August, 1993. They are Development and Commercial Bank Berhad, Kwong Yik Bank Berhad, Perwira Habib Bank Berhad, Standard Chartered Bank Berhad, Arab-Malaysian Finance Berhad, BBMB Kewangan Berhad, Mayban Finance Berhad, MBF Finance Berhad, Public Finance Berhad and Arab-Malaysian Merchant Bank Berhad. Their participation would increase the number of branches offering Interest-Free Banking services to 440¹⁶⁵ (not including *BIMB*'s 44 branches).¹⁶⁶

In future, more financial institutions are expected to offer the Interest-Free Banking services in addition to their existing services.¹⁶⁷ On the future of Islamic banking and finance in Malaysia, Abdul Halim offers a bright prospect:

The market can be big, but it has to be nurtured and developed in an orderly manner...The success of Islamic banking will also depend on the political stability, economic growth and a visionary leadership which we are enjoying now. And assuming that it's efficient (like conventional banking), it should attract non-Muslim customers too, which means the market should grow. Above all, the Islamic banking and financial system is expected to play an important role - which is to attain the economic objectives of restructuring the *Bumiputera* community and Vision 2020 (when Malaysia is expected to be an

¹⁶⁵ Othman Abu Bakar, "Interest-Free Banking Nationwide in a Year" in *New Sunday Times*, 22 August, 1993, p. 1; A. Rachel (1993), *op cit.*, p. 26; Abdul Monir Yaacob, "SPTF Perlu Diperluaskan Lagi" in *Dewan Ekonomi*, May, 1994, pp. 12 - 13; Dinsman, "AMFB Menerokai Pembiayaan Cara al-Musyarakah", in *Dewan Masyarakat*, (Kuala Lumpur, May 1994), pp. 45 - 46.

¹⁶⁶ This figure includes 12 mini branches of *BIMB* opened during the financial year of 1993 at Baling, Tanah Merah, Dungun, Masjid Tanah, Kluang, Subang Jaya, Banting, Bandar Pusat Jengka, Kota Tinggi, Jasin, Sri Manjung and Kulim. These are deposit taking-taking branches providing current account, savings account and investment account facilities. See *BIMB, Annual Report 1993*, pp. 10, 67 -70.

¹⁶⁷ According to Nor Mohamed Yacob, Bank Negara adviser, that in the future all 37 commercial banks, 12 merchant banks and 41 finance companies will have all or part of their nation-wide branches offering the interest-free banking services. Quoted in *New Sunday Times*, 22 August 1993, p. 1.

Conclusion

In this chapter, we have seen that the Islamic mode of banking is both theoretically feasible and practically possible. The Islamic Banking system has provided practical evidence of the possibility of an interest-free banking system in the modern world. Muslim scholars and economists are all agreed that Islamic Banking will be based on the commercial contracts of *muḍārabah* and *mushārah* as already explained in the first and second chapters, and other modes of financing such as *murābahah* and *bay' bi thaman ājil*. The above discussion also provides strong evidence of how transactions can be made according to the Islamic commercial law through the modern financial intermediary of the banking system. It is encouraging to note that Islamic banking in Malaysia is functioning successfully side-by-side with conventional banks. However, available evidence clearly suggests that there is tendency for the *BIMB* to confine its profit-generating operations to almost risk-free techniques to ensure success. Consequently, it creates the bank's over reliance on *murābahah* and *bay' bi thaman ājil* modes of financing rather than the entrepreneur-creating operations of *muḍārabah* and *mushārah*. To a certain degree, people doubt the bank's genuine intention to apply Islamic principles in banking, thus the bank has been unable to influence the pattern of the distribution of profit between the providers and the users of capital in a more equitable manner as enjoined in Islam. It may be argued that more meaningful outcomes could have been achieved, had the bank placed greater emphasis on the first-line techniques of *muḍārabah* and *mushārah*.

¹⁶⁸ Kuala Lumpur Stock Exchange, *Investors Digest*, April, 1993, p. 11.

CHAPTER FOUR

MUḌĀRABAH IN THE OPERATION OF SYARIKAT TAKAFUL MALAYSIA SENDIRIAN BERHAD

CHAPTER FOUR : *MUDĀRABAH IN THE OPERATION OF SYARIKAT TAKAFUL MALAYSIA SENDIRIAN BERHAD*

Introduction

This chapter will critically analyse the establishment and operations of *Syarikat Takaful Malaysia Sendirian Berhad (STMSB)*¹ as the only one company granted permission to operate Islamic insurance business based on the contracts of *muḍārabah* and *takāful*. The topics that will be discussed include the nature of insurance, an Islamic view on present-day insurance, the historical development of *Syarikat Takaful*, types of *takāful* business, contributions and investments of the Family *Takāful* Fund, Group Family *Takāful* Fund and General *Takāful* Fund, as well as the investment of *Syarikat Takaful*'s shareholders Funds, evaluation of the performance of *Syarikat Takaful*'s role as an Islamic financial institution in Malaysia and some issues relating to the *takāful* scheme.

4.1. Nature of Insurance

The term 'insurance' in its real sense refers to community pooling to alleviate the burden of the individual, which might be ruinous to him. The simplest and most general conception of insurance is a provision made by a group of persons, each singly in danger of some loss, the incidence of which cannot be foreseen, that when

¹ Hereafter referred to as *Syarikat Takaful*.

such loss shall occur to any of them, it shall be distributed over the whole group.² Insurance has been described as a device provided by the community or group of people to cover loss,³ or an arrangement against risk,⁴ or against the dangers⁵ which beset human life and dealings, when they occur to the members of that community or group of people, by creating funds to cover losses or against that risk.⁶

In its modern form, insurance can be described as a contract whereby one person called the "insurer" undertakes, in return for the agreed consideration called the "premium", to pay another person called the "insured", a sum of money or its equivalent, on the happening of a specified event.⁷ The aim of insurance is to make provision against the dangers to which a group of persons are all equally subject. Insurance is thus a mutual coverage of accidental loss by a group of persons subject to a common danger.⁸ In the present form of insurance, losses are not distributed but

² Entry on "Insurance" in *Encyclopedia Americana*, Vol. XX, Connecticut, 1984, p. 233; *The New Encyclopaedia Britannica*, Vol. XXI, Chicago, 1985, p. 678.

³ Those who describe insurance as "pooling of losses" in E. Cannan, *A Review of Economic Theory*, London, 1929, p. 424; *Encyclopaedia of Banking and Finance*, p. 385; "distribution of losses", W. F. Gephart, *Principles of Insurance*, New York, 1911, pp. 4 - 5; "mitigation of losses", *Ibid.*, pp. 1 - 2; "Indemnifying of losses", L. D. Edie, *Economics : Principles and Problems*, London, 1926, p. 215 and "meeting of losses", A. H. Silverman, *The Substance of Economics*, London, 193, p. 164.

⁴ See C. Gide, *Political Economy*, London, 1914, p. 745; S. H. Patterson and K. W. H. Schholz, *Economic Problems of Modern Life*, New York and London, 1931, p. 98; M. Dobb, *Capitalist Enterprise*, London, 1925, pp. 53 and 164; Marks Dordman says that risk can be divided into four categories, i. e. subjective risk, objective risk, pure risk and speculative risk. See *Introduction to Insurance*, Englawood Cliffs, 1982, p. 9.

⁵ T.W. Morgan (ed.), *Porter's Laws of Insurance*, London, 1933, p. 1.

⁶ H. Barou, *Cooperative Insurance*, London, 1936, p. 40; see also Adam Smith, *The Wealth of Nations*, Edwin Cannan (ed.), Vol. II, London, 1950, p. 248.

⁷ E. R. Hardy Ivamy, *General Principles of Insurance Law*, London, 1975, p. 3; See an entry "Insurance" in *The New Encyclopaedia Britannica*, Vol. XXI, p. 678.

⁸ T. W. Morgan (ed.), (1933), p.

funds are created to cover the losses calculated in advance with the aid of past experience.⁹ Thus, it can be seen that insurance involves the spirit of mutuality and co-operation.

The modern contract of conventional insurance seems to have its origin in the marine loans of ancient Greeks.¹⁰ As against the ancient Greek marine loan, the idea of mutual insurance finds its expression in the payment of blood money¹¹ (*‘āqilah*) which was prevalent in Arab tribes during the pre-Islamic times.¹² This virtue of pre-Islamic times was approved and incorporated into Islam by the Prophet, and later acted upon by Caliph ‘Umar.¹³ The nature of blood-money was neither usurious, nor exploitative. It ingrained the spirit of mutuality, co-operation and mutual insurance, and eliminated the danger of wars of revenge which continued in pre-Islamic Arabia for decades.

⁹ H. Barou (1936), *op. cit.*, p. 40.

¹⁰ This marine loans of ancient Greeks described by Demosthenes: "Money was advanced on a ship or cargo, to be repaid with large interest if the voyage prospered, but not repaid at all if the ship be lost, the rate of interest being made high enough to pay not only for the use of capital, but for the risk of losing it". (Entry on "Insurance", in *The New Encyclopaedia of Britannica*, Vol. XXI, 1989, p. 678). According to Barou, "The rate of interest includes together with other elements a premium for insurance in order to provide compensation for the loan to the lender, in case of a loss incurred through the bankruptcy of the borrower". (See H. Barou, *Cooperative Insurance*, London, 1936, p. 25). Thus it can be said that the modern contract of insurance is basically the same (usurious in nature) as the old marine loan of ancient Greeks. (M. Muslehuddin, *Insurance and Islamic Law*, New Delhi, 1982, pp. 27- 28).

¹¹ or blood-wite. See Th. W. Juynboll, "*Ākila*", in *El (I)*, Vol. I, 1913, p. 239.

¹² Muslehuddin, *op. cit.*, pp. 10 - 11; Juynboll, "*Ākila*", pp. 239 - 240. *‘Āqilah* is the name of the man's male relations who according to the precept of the religious law have to pay the penalty (the *‘āqil*) for him, when unintentionally he has caused the death of a Muslim. This decree was based on a verdict of the Prophet. One day in a quarrel between two women of the Hudhayl tribe, one of them who was with child was killed by the other with a stone, which hit her in the womb. When, soon after, the other woman also died, the Prophet decided, that her kin (*‘āqilah*, or, according to a different reading her *‘āsabah*, i. e. agnates), in accordance with an old custom, had to pay the penalty to the relatives of the woman who had been killed. (Muslehuddin, *op. cit.*, p. 11; Juynboll, "*Ākila*", p. 239).

¹³ Muslehuddin, *op. cit.*, p. 23; See also *Hidāyah*, Vol. IV, p. 642; M. Hamidullah, *The First Written Constitution in the World*, Lahore, 1981, pp. 41 - 42 and 44 - 45.

4.2. An Islamic View of Present-Day Insurance

Insurance has undoubtedly assumed tremendous importance in modern commerce, trade and industry. The contract of insurance has been the subject matter of prolonged and detailed studies, examination and scrutiny by and amongst eminent Islamic scholars, who have come to different conclusions, views and opinions. There at least three standpoints: That it is permissible (*mubāḥ*), that it is prohibited (*ḥarām*) and that some forms are allowed and others disapproved.¹⁴

The proponents of the permissibility of insurance (*ta'mīn*)¹⁵ declare that such contract is allowed if it is free from *ribā*. It is considered as a collective undertaking (*ʿamal taʿāwunī*) which takes care of the welfare (*maṣāliḥ*) of individuals and society. In so far as *maṣlahah* is achieved, it is in compliance with the law. Moreover, originally all contracts are permissible and as such it can be equated by analogy to various permissible contracts.¹⁶ Justification based on public interest and even on the socio-economic survival of the Muslim Ummah has also been put forward.¹⁷

¹⁴ Aḥmad al-Saʿīd Sharaf al-Dīn, *ʿUqūd al-Tāʾmīn wa ʿUqūd Ḍamān al-Istithmār*, pp. 88 - 94; M. Muslehuddin, *Insurance and Islamic Law*, New Delhi, 1982, pp. 109 - 125.

¹⁵ *Ta'mīn* became the Arabic term for insurance in the 20th century. (E. Klingmuller, "The Concept and Development of Insurance in Islamic Countries", *IC*, Vol. XXXIII (1), 1969, pp. 27 - 37). Ibn ʿĀbidīn, however, a Hanafī jurist who is considered the first Muslim to name insurance *sukara* (security), influenced by the Italian term *siguare* and the Turkish *sigorta*. (Hash A., Vol. IV, pp. 170 - 173; Vardit Risper-Chaim, "Insurance and Semi-Insurance Transactions in Islamic History Until the 19th Century", *JESHO*, Vol. XXXIV, 1991, pp. 142 - 143).

¹⁶ A. S. Sharaf al-Dīn, *op. cit.*, p. 90.

¹⁷ Muḥammad al-Bahī, *ʿAqd al-Ta'mīn*, p. 23.

The justifications of *ta'min* advanced by Muṣṭafā Zarqā'¹⁸ and ʿAlī al-Khafīf,¹⁹ leading contemporary scholars, have been overwhelmingly accepted. Firstly, it is argued that *ta'min* is a newly known contract not covered by a text (*naṣṣ*) whether approving or disapproving of it. It should thus be considered allowed (*jā'iz*) and permissible (*mubāḥ*). Secondly, since it is a contract based on *maṣlahah* and since there is no aspect of any harm (*ḍarar*), it complies with the prescribed law. Thirdly, insurance has become a common usage (*ʿurf ʿāmm*) necessary for the attainment of private and public interests. *ʿUrf* is considered to be a source of law, as long as it does not contradict the precepts of the *Shariʿah*.²⁰

The proponents of the prohibition of insurance argue that it contains the elements of *ribā* (usury), *gharar* (risk), *jahālah* (uncertainty), *maysir* (gambling and unearned gain), and attempting to supersede the will of God, all of which is said to be diametrically opposed to the ethical standards set by Islamic law.²¹ Muḥammad Abū Zahrah has made the qualification that *ta'min* not founded on a collective basis (*al-ta'min ghayr al-ta'āwunī*) is reprehensible (*makrūh*). Such a decision is established on the basis of the classical methodology of *ʿUlamā' al-salaf* that no prohibition will be pronounced except where there is an explicit evidence (*dalīl qaṭʿī*).²²

¹⁸ His finding on this matter was delivered in the *Usbūʿ al-Fiqh al-Islāmī* in Damascus (1961) as well as in his deliberation at the Mecca Conference (1976).

¹⁹ His opinions submitted to the second assembly of the *Majmaʿ al-Buḥūth al-Islāmiyyah* (Islamic Research Academy) of al-Azhar University in which he excluded life insurance from the list of validated insurances.

²⁰ A. S. Sharaf al-Dīn, *op. cit.*, p. 90.

²¹ M. Muslehuddin, *op. cit.*, p. 109; A. S. Sharaf al-Dīn, *op. cit.*, p. 88.

²² For details on the polemic between Muḥammad Abū Zahrah and Muṣṭafā Aḥmad al-Zarqā', see Zarqā''s works *ʿAqd al-Ta'min wa mawqif al-Shariʿah al-Islāmiyyah minhu* (A lecture delivered during the *Usbūʿ al-Fiqh al-Islāmī*), Damascus, 1962 and a recent work *ʿAqd al-Ta'min fi al-Shariʿah al-Islāmiyyah*, 1982.

The third group hold that some forms of *ta'mīn* are allowed and some are prohibited. Some of them allowed the use of *ta'mīn* on property but ban life insurance.²³ However, an overwhelming majority of Islamic scholars are now of the opinion that the conventional insurance contract does not, in its present form, conform to the *Sharī'ah* because it includes an element of *gharar* (uncertainty), based on the practice of *ribā* and a sort of gambling (*maysir*).²⁴

4.3. The Establishment of *Syarikat Takaful Malaysia Sendirian Berhad* (STMSB)²⁵

4.3.1. Origin/Historical Development of *Syarikat Takaful Malaysia Sendirian Berhad*

The need in Malaysia for a scheme of insurance which is in line with Islamic teachings was officially affirmed when the National *Fatwa* Committee²⁶ declared in 1972 that the conventional concept of life Insurance as practised in Malaysia was

²³ Siddiqi, *op. cit.*, p. 26.

²⁴ Insurance has been discussed at a number of Islamic conferences, but a favourable verdict on commercial insurance has been withheld in view of the objections of the eminent scholars. This is brought out by the resolutions passed at the 1965 Islamic Research Congress at Cairo and those adopted in 1969 at Kuala Lumpur. See Siddiqi, *Muslim Economic Thinking : A Survey of Contemporary Literature*, Leicester, 1981, p. 27. As recently as 1976 the First International Conference on Islamic Economics held at Mecca resolved that: "The Conference feels that commercial insurance as presently practised does not realise the *Sharī'ah*'s aims of co-operation and solidarity because it does not satisfy the Islamic conditions for it to become acceptable". Furthermore, the conference recommended the establishment of a committee consisting of specialists in *Sharī'ah* and economics to recommend a system of insurance which is free from *ribā* and speculation, promotes co-operation in accordance with the *Sharī'ah*, and helps replace the current form of commercial insurance. See General Recommendations, no. 6, First International Conference on Islamic Economics, Mecca, 1976 cited in Siddiqi, *Muslim Economic Thinking*, p. 27.

²⁵ Hereafter cited to as *Syarikat Takaful*.

²⁶ The National *Fatwā* Committee is made up of 14 *muftis* from 14 states in Malaysia.

unlawful in Islam as it contained the elements of *ribā*, *gharar* and *maysir*.²⁷

Gharar

Gharar means obvious indeterminacy, hazard or risk (*khaṭar* or *mukhāṭarah*) and ignorance that is likely to cause disputes which, when applied to insurance, means the presence of unknown and uncertain factors in the operation of the contract.²⁸ This element of *gharar* (or uncertainty) is found in the operation of conventional insurance, both life and general insurance contracts. In such a contract, the insured or the policy holder agrees to pay a certain sum as a premium and in turn the insurance company guarantees to pay a certain sum of compensation in the event of a catastrophe or disaster. The uncertainty relates to the fact that the insured or the policy holder is not informed, for example, of how the amount of the compensation that the company will pay him is to be derived.²⁹

²⁷ *Report of the Committee on the Setting-up of an Islamic Insurance Company in Malaysia*, Kuala Lumpur, 1984, p. 1.

²⁸ *Lisān*, Vol. V, pp. 13 - 14; Lane, Vol. II, p. 2239; In Islamic terminology, this is a sale of an article of goods which is not present at hand; or the sale of an article of goods, the consequence (*‘āqibah*) or outcome of which is not known; or a sale involving risk or hazard where one does not know whether the commodity will later come to be or otherwise. *A‘lām*, Vol. I, p. 358; Zurqānī, Vol. III, p. 313; Ramli, *Nihayat al-Muhtāj*, Vol. III, p. 335; *Muw. Y.*, pp. 554 - 555. The term means that such transactions, which are prohibited in Islam, in form are apparently no different from those prohibited in Islam for deceiving when in reality the nature of the object is not known and therefore risk involved. Several reasons are given for the prohibition of *bay‘ al-gharar*. Some of them are related to fraudulence since such a sale amounts to obtaining the property of others by selling unavailable goods and the contract may lead to disputes and disagreements between the parties in the contract. Sahnūn, Vol. IV, p. 207; Zurqānī, Vol. III, p. 313; *Musannaf*, Vol. VIII, pp. 108 - 109; Muzānī, Vol. VIII, p. 185; *Muḥallā*, Vol. VIII, pp. 399 - 400; See also al-Saddiq Muḥammad al-Amin al-Darir, *al-Gharar wa Atharuhu fī al-‘Uqūd fī al-Fiqh al-Islāmī : Dirāsah Muqāranah*, Cairo, 1967, p. 27; Coulson, *Commercial Law*, p. 44; Franz Rosenthal, *Gambling in Islam*, Leiden, 1975, p. 139.

²⁹ *STMSB, Risalah Perlindungan Takāful*; M. F. Yusuf, "Takaful Insurance Company Malaysia Sdn. Bhd.", *Syariah Law Journal*, (International Islamic University, Petaling Jaya, September, 1991), p. 87; Cf Afzalur Rahman, *Banking and Insurance*, Vol. IV, London, 1979, pp. 133 - 142.

Maysir

Closely related to and justified by Islam's wider prohibition against unearned gains, is the prohibition of all transactions containing an element of *maysir*. *Maysir*, though similar to it, is far wider than the concept of gambling, gaming and wagering. Generally, it means unnecessary risk by entering into a transaction with the hope of gain as well as the fear of loss,³⁰ or undertaking a risk in the spirit of speculation.³¹ Insurance is said to contain the element of *maysir*, when a life policyholder dies before the end of his insurance policy after paying only part of the premium, so that for example, his dependents will receive a certain sum of money which exceeds what the insured paid in premiums. Similarly, in non-life insurance, if the insured event occurs and results in a huge loss, the insured will recover more than which he has paid in premium. On the other hand, if the insured event does not take place, the insured gets nothing tangible in return for his premiums.³²

Ribā

The practice of *ribā* and other related practices which contraven the rules of the *Shari'ah* enter into the investment activities of the conventional insurance

³⁰ M. N. Siddiqi, *Insurance in an Islamic Economy*, Leicester, 1985, p. 34; *Tāj*, Vol. XIV, pp. 453 - 479.

³¹ S. H. Amin, *Islamic Law in the Contemporary World*, Glasgow, 1985, pp. 71 - 84.

³² STMSB, *Risalah Perlindungan Takāful*; *Idem*, *Risalah Pelan Takāful Keluarga (A) and (B)*; M. F. Yusuf (1991), *op. cit.*, p. 88; Nik Ramlah N. Mahmood, "Takaful : The Islamic System of Mutual Insurance - The Malaysian Insurance", *Arab Law Quarterly*, Feb., 1991, p. 285.

companies.³³

In 1982, a Committee set up by the Government to study the implementation of the Islamic system of insurance in Malaysia recommended the introduction of the *takāful* scheme of insurance. The Committee also included in its report a draft proposal for the *Takaful Bill 1984* which provided for the setting-up, control and regulation of *takāful* businesses and other related matters. Following the acceptance by the Government of introducing *takāful* businesses in Malaysia, the Parliament gazetted the *Takaful Act* in 1984,³⁴ and finally a *Takaful* Company was incorporated as a private limited company under the *Companies Act 1965*³⁵ on 29th November 1984, taking the name of *Syarikat Takaful Malaysia Sendirian Berhad (STMSB)*, with its registered office situated in Malaysia. The Company started its business on 2nd August 1985.³⁶

To underline the importance of its Islamic character, the *Takaful* Company's Memorandum of Association prefaces that "all businesses of the Company will be

³³ Afzalur Rahman, *op. cit.*, pp. 108 - 114; Muhammad Samiullah, "Prohibition of *Ribā* (Interest) and Insurance in the Light of Islam", *IS*, Vol. XXI (2), (1982), pp. 53 - 76; M. A. Choudhury, "Insurance and Investment in Islamic Perspective", *International Journal of Social Economics*, Vol. X (95), Fresno, 1983, pp. 16 - 17.

³⁴ The Act seeks to provide for the licensing and regulating of *takāful* business in Malaysia. See S. (1), *Takāful Act 1984*. It has been modelled on Malaysia's existing *Insurance Act 1963* with modifications and amendments as are necessary to conform with the *takāful* business practices. However, according to the provisions of the *Takāful Act 1984*, for example S. 67 (2), *Takāful Act 1984* provides that the supervisory authority responsible for the supervision of all regulations over the *Takāful* Company is vested in the Ministry of Finance through the Director-General of *Syarikat Takaful*.

³⁵ S. 4 (1) (a), *Takaful Act 1984* provides "Subject to this Act, *takāful* business shall not be carried on in Malaysia by any person as *takāful* operator except by a Company as defined in the *Companies Act 1965*".

³⁶ *STMSB, Annual Report 1986*, pp. 5 - 6.

transacted in accordance with Islamic principles, rules and practices",³⁷ The Company has an authorized capital of RM 100 million, divided into 100 million ordinary shares of RM 1 each. The initial paid-up capital of the Company is RM 10 million, 51 per cent of which is held by *BIMB*; and the other shareholders are the State Religious Councils and the State Religious Agencies of Malaysia.³⁸ This ownership of shares makes *Syarikat Takaful* a subsidiary of *BIMB*.

4.3.2. The Concept of *Takāful* (Mutual Insurance) and *Mudārabah*

In this section, we discuss the principles of *takāful* and *mudārabah* which are used as modes of operation of *Syarikat Takaful*.

Literally, *takāful* means mutual guarantee, joint guarantee and co-operation³⁹ and these are the hallmarks of this scheme. This concept embodies the principles of co-operation, mutual help and shared responsibility.⁴⁰ The *Takaful Act 1984* of Malaysia defines *takāful* as a scheme based on brotherhood, solidarity and mutual assistance which provides for mutual financial aid and assistance to the participants in case of need, whereby the participants mutually agree to contribute for that purpose.⁴¹

³⁷ *STMSB, Annual Report 1986*, p. 5; Mohd. Fadzli Yusuf, "Takaful Insurance Company Malaysia Sdn. Bhd. : Islamic Alternative to Insurance" in *International Islamic University Syariah Law Journal*, September 1991, p. 92.

³⁸ *STMSB, Annual Report 1986*, p. 5; *BIMB, Annual Report 1986*, p. 7; See also S. W. Ahmad, "Islamic Insurance in Malaysia" in Mohamed Ariff (ed.), *The Muslim Private Sector in Southeast Asia*, Singapore, 1991, pp. 197 - 198;

³⁹ *Lisān*, Vol. XI, pp. 589 - 590; Lane, Vol. I. p. 3001; R. Dozy, *Supplement Aux Dictionnaires Arabes*, Vol. II, Leiden and Paris, 1927, p. 478; H. Wehr, *Arabic-English Dictionary*, ed. J. M. Cowan, New York, 1976, p. 834.

⁴⁰ For example, see Sami A. Hanna, "*Al-Takāful al-Ijtimā'ī* and Islamic Socialism", *The Muslim World*, Vol. LIX, 1969, pp. 275 - 286; Nik Ramlah N. Mahmood, *op. cit.*, pp. 286 - 287.

⁴¹ *Takaful Act 1984*, s. 2.

Takāful is characterised by three aspects of mutuality, namely, mutual help, mutual responsibility and mutual protection from losses. The "insurance" that is provided is not dispensed by one party (the insurer) to another (the insured). The person seeking protection participates in a scheme of co-operation with another.⁴² The *Syarikat Takaful* (*Takaful* Company) that runs the scheme is not the insurer but is merely an institution which provides the entrepreneurial and administrative skills required to bring the participants together, to collect and invest the contribution and to process the claims. Therefore, this scheme can be seen as a method of joint guarantee among a group of members, that is, participants in any scheme against loss or damage that may fall upon any of them. The members of the group agree to guarantee jointly that should any of them suffer a catastrophe or disaster, he would receive a certain sum of money to help him meet the loss or damage. This means that participants pledge mutual help amongst the group and each member of the group pools effort to support the needy.⁴³

In the practice of *Syarikat Takaful Malaysia Sendirian Berhad* (STMSB), the concept of *takāful* has been developed as a form of business and the principle of *muḍārabah* has been applied in the contract between *Syarikat Takaful* and the participants. Under the contract of *takāful* based on the principle of *muḍārabah*, *Syarikat Takaful* acts as an entrepreneur or investor (*muḍārib*) and accepts *takāful*

⁴² Syed Waseem Ahmad, "Islamic Insurance In Malaysia", in Mohamed Ariff (ed.), *The Muslim private Sector in Southeast Asia*, Singapore, 1991, pp. 191 - 192.

⁴³ *Report of the Committee on the Setting-up of an Islamic Insurance Company in Malaysia*, Kuala Lumpur, 1984, p. 8; Mohd. Fadzli Yusuf, "The Operation of Syarikat Takaful Malaysia Sendirian Berhad", p. 5. Paper presented at the *Seminar on Insurance in Malaysia for Journalist*, Kuala Lumpur, 1985; *Idem*, "The Principles of Islamic Insurance", p.5. Paper presented at the *Seminar on Issues in Economics*, 27 - 29 December 1985, Petaling Jaya, Malaysia.

contributions or payment of the *takāful* instalments termed as *ra's al-māl* (capital) from participants, who are treated as investors or providers of capital (*aṣḥāb al-māl*).⁴⁴

The *takāful* contract which is made in accordance with the principle of *mudārabah* specifies how the profit (surplus) from the operations of *takāful* managed by *Syarikat Takaful* is to be shared between the participants as the providers of the capital and *Syarikat Takaful* (company) as the entrepreneur (investor). The sharing of such profit may be in a ratio of, for example, 5 : 5, 6 : 4, 7 : 3, et cetera as mutually agreed between the contracting parties. The contract also clearly states the rights and obligations of both the participants and the *Syarikat Takaful*.⁴⁵

4.3.3. The Concept of *Tabarru'*

Another special feature of *takāful* contract is the concept of *tabarru'* which means to donate, to contribute.⁴⁶ Under the *takāful* contract, the participants agree to relinquish as donations, in accordance with the concept of *tabarru'*, a certain proportion of their *takāful* contributions of mutual help as embodied in the concept of *takāful*. Therefore, the purpose of *tabarru'* as stipulated in the contract is to enable the participants to perform their obligations in assisting and helping fellow participants who might suffer a loss or damage due to death or disasters. The sharing

⁴⁴ STMSB, *Risalah Perlindungan Takaful*, n. d.; Mohd. Fadzli Yusof, "Takāful Insurance Company Malaysia Sdn. Bhd. : Islamic Alternative to Insurance", in *Syariah Law Journal*, Petaling Jaya, Selangor, September 1991, p. 88; Tajuddin Saman, "Takāful Berasaskan Mudārabah" in *Berita Harian*, 22 May 1992, p. 9; Johari Jaafar, "Skim Takāful Bantu Masyarakat Islam" in *Berita Minggu*, 5 July 1992, p. 10.

⁴⁵ STMSB, *Risalah Perlindungan Takaful*.

⁴⁶ *Tāj*, Vol. XX, p. 319; Lane, Vol. I, p. 189; Dozy, *Supplement*, Vol. I, p. 73.

of the profits or surplus from the operations of *takāful*, according to the principle of *muḍārabah*, is made only after the obligations of assisting fellow participants have been fulfilled. *Syarikat Takāful* has to meet these obligations as well as generate a reasonable level of profits by maintaining adequate assets in its *takāful* funds, whilst at the same time striving prudently to protect the funds against undue exposure.⁴⁷

4.3.4. Types of *Takāful* Business

There are two types of *takāful* business offered by *Syarikat Takāful*, namely, Family *Takāful* Plans and General *Takāful* Schemes.⁴⁸ In the context of ordinary insurance, the Family *Takāful* Plans and the General *Takāful* Scheme can be compared with life and non-life insurances respectively.⁴⁹

The Family *Takāful* Plans provide various family *takāful* plans based on a *muḍārabah* contract. The plans provide cover of mutual financial aid and assistance from the *takāful* benefits, in case of the untimely death of a participant.⁵⁰ The General *Takāful* Scheme provides various general *takāful* schemes as a form of a protection

⁴⁷ STMSB, *Risalah Perlindungan Takaful*; Mohd. Fadzli Yusuf (1985.b), "The Principles of Islamic Insurance", p. 7; *Idem*, "Sumbangan Takaful Kepada Usahawan", p. 7. A Paper presented at the *Seminar Keusahawanan dan Perniagaan Islam*, 28 - 29 November 1987, Petaling Jaya, Malaysia; *Idem*, "Berbakti Kepada Rakan Melalui Tabarru'" in *Berita Harian*, 7 October 1994, p. 3; Johari Jaafar (1992), *op cit.*, p. 10;

⁴⁸ The *Takaful Act 1984* divides the *takāful* business into the Family Solidarity Business or Family *Takāful* Plans and the General *Takāful* Business (Scheme). (*Takaful Act 1984*, s. 3). The former is defined as *takāful* for the benefit of individual and his family, while the latter is defined as all *takāful* business which is not Family Solidarity Business. (*Takaful Act 1984*, s. 3. a(i) and (ii).

⁴⁹ See S. 3 (2), *Insurance Act 1963*.

⁵⁰ STMSB, *Risalah Pelan Takaful Keluarga (a) and (b)*; *Idem*, *Annual Report 1986*, p. 6; Mohd. Fadzli Yusuf (1987), "Sumbangan *Takāful* Kepada Usahawan", p. 12; Barjoyai Bardai, "Skim *Takāful* Keluarga dan Operasinya" in *Berita Minggu*, 3 January 1992, p. 8.

for an individual or a body corporate against material loss or damage arising from catastrophes, disasters or mishap inflicted upon properties or assets belonging to participants such as buildings, houses, vehicles, stock in trade, et cetera.⁵¹

Although the Act introduces a new scheme which is supposed to comply with Islamic principles, the Act itself has a few provisions as to how the scheme should operate, except that it must be in accordance with the *Shari'ah*. The general operation of the scheme is a matter of practice and it was recommended that the practices of existing insurers, as long as they comply the *Shari'ah* principles, ought to be followed.

(a) Family *Takāful* Plans

A Family *Takāful* Plan, which is essentially an investment programme, provides investment returns to a participant as well as mutual financial aid. Any individual or a corporate body may participate in this *takāful* plan so that he will be able to save regularly a sum of money as a measure to relieve the financial burden that his dependents may face should he die prematurely or as a form of contingency should he survive the term of the plan.⁵² Therefore, the objectives of the Family *Takāful* Plans have been described to enable a person:

1. to save regularly
2. to invest this saving with a view to earning profits in accordance with the rules and requirement of the *Shari'ah*

⁵¹ STMSB, *Risalah Perlindungan Takaful*; STMSB, *Annual Report 1986*, p. 7.

⁵² *Risalah Perlindungan Takaful*; Mohd. Fadzli Yusuf (1987), "Sumbangan Takaful Kepada Usahawan", p. 12.

3. to provide cover in the form of a payment of *takāful* benefits to an heir or heirs should a participant die before the maturity date of his *takāful* plan.⁵³

Syarikat Takaful offers to an individual or a corporate body the following Family *Takāful* Plans:

1. Family *Takāful* Plans with a maturity of 10, 15, 20 and up to 40 years, which must mature before the participant reaches the age of 60 years⁵⁴
2. Family *Takāful* Plans for Mortgage⁵⁵
3. Family *Takāful* Plans for Education
4. Group Family *Takāful* Plans.⁵⁶

A person who wishes to participate in the Family *Takāful* Plans, who is then called a participant,⁵⁷ may choose any one of the types of plans offered by *Syarikat Takaful* (or the operator)⁵⁸ as mentioned above. Any plan has a defined period of participation such as 10, 15 or 20 year terms. The age groups covered under any Family *Takāful* Plan with various maturity periods range from 18 to 50 years. The participants and the *Syarikat Takaful* enter a *takāful* contract based on the principle

⁵³ STMSB, *Pelan Takāful Keluarga (A) and (B)*.

⁵⁴ STMSB, *Annual Report 1986*, p. 6; *Idem*, *Risalah Pelan Takaful Keluarga (a) and (b)*.

⁵⁵ STMSB, *Annual Report 1986*, p. 6; *Idem*, *Risalah Perlindungan Takaful*.

⁵⁶ STMSB, *Annual Report 1988*, p. 7; *Annual Report 1989*, p. 6; *Annual Report 1990*, p. 5; *Annual Report 1991*, p. 5.

⁵⁷ S. 2 *Takāful Act 1984* Provides that "Participants" includes, where a certificate has been assigned, the assignee for the time being and, where they are entitled as against the *takāful* operator to the benefit of the certificate, the personal representatives of a deceased participant.

⁵⁸ S. 2 *Takāful Act 1984* provides that "operator" means a company or a society which carries on *takāful* business.

of *mudārabah* and the participants agree to pay regularly to the *Syarikat Takaful* the *takāful* contributions (instalments) (premium), monthly, quarterly or annually which are then credited into a fund (Family *Takāful* Fund).⁵⁹ The contract spells out clearly the rights and obligations of the contracting parties.

As shown in Figure 4.1 below, each *takāful* instalment (contribution) paid by the participant and credited into the Family *Takāful* Fund shall in turn be divided and credited by the *Syarikat Takaful* into two separate accounts, namely:

1. The Participant's Account (PA), and
2. The Participant's Special Account (PSA).

A substantial proportion of the instalments is credited into the PA solely for the purpose of savings and investment. The balance of the instalment is credited into the PSA as *tabarru'*^c which depends on the age group and maturity period of the participants. As shown in Table 4.1, the *tabarru'*^c proportion varies from two per cent to twelve and a half per cent. The remaining proportion of the instalment is credited into the participant's account. It is out of the PSA that *Syarikat Takaful* is to pay the *takāful* benefits to the heir(s) of a participant who may die before the maturity of his Family *Takāful* Plan. In other words, money paid into the PSA is paid by the participant in the spirit of *tabarru'*^c.⁶⁰

⁵⁹ The amount of *takāful* instalment to be paid during the term of the plan is determined by the participants themselves. Such amount, however, should be within the financial means of the participants and also subject to the minimum sum fixed by the *Syarikat Takaful* which at present is RM 15.00 per month payable on a monthly, quarterly or annually basis. See *Risalah Pelan Takaful Keluarga (a) and (b); Risalah Perlindungan Takaful*.

⁶⁰ *STMSB, Risalah Perlindungan Takāful*; Mohd. Fadzli Yusuf (1991), "Takaful Insurance Company Malaysia Sdn. Bhd.", p. 90; Nik Ramlah N. Mahmood, *op. cit.*, p. 288.

Table 4.1

Syarikat Takaful : Ratios of *tabarru*^c proportion credited into PSA accounts

Age Group (Years)	Maturity Period (Years)						
Age Group (Years)	10	15	20	25	30	35	40
18 - 25	2.0%	3.5%	5.0%	5.5%	7.5%	9.5%	12.5%
26 - 30	2.0%	3.5%	5.0%	6.5%	9.0%	12.5%	
31 - 35	2.5%	4.5%	6.5%	9.0%	12.5%		
36 - 40	3.5%	6.0%	9.0%	12.5%			
41 - 45	5.0%	8.5%	12.5%				
46 - 50	7.0%	12.5%					

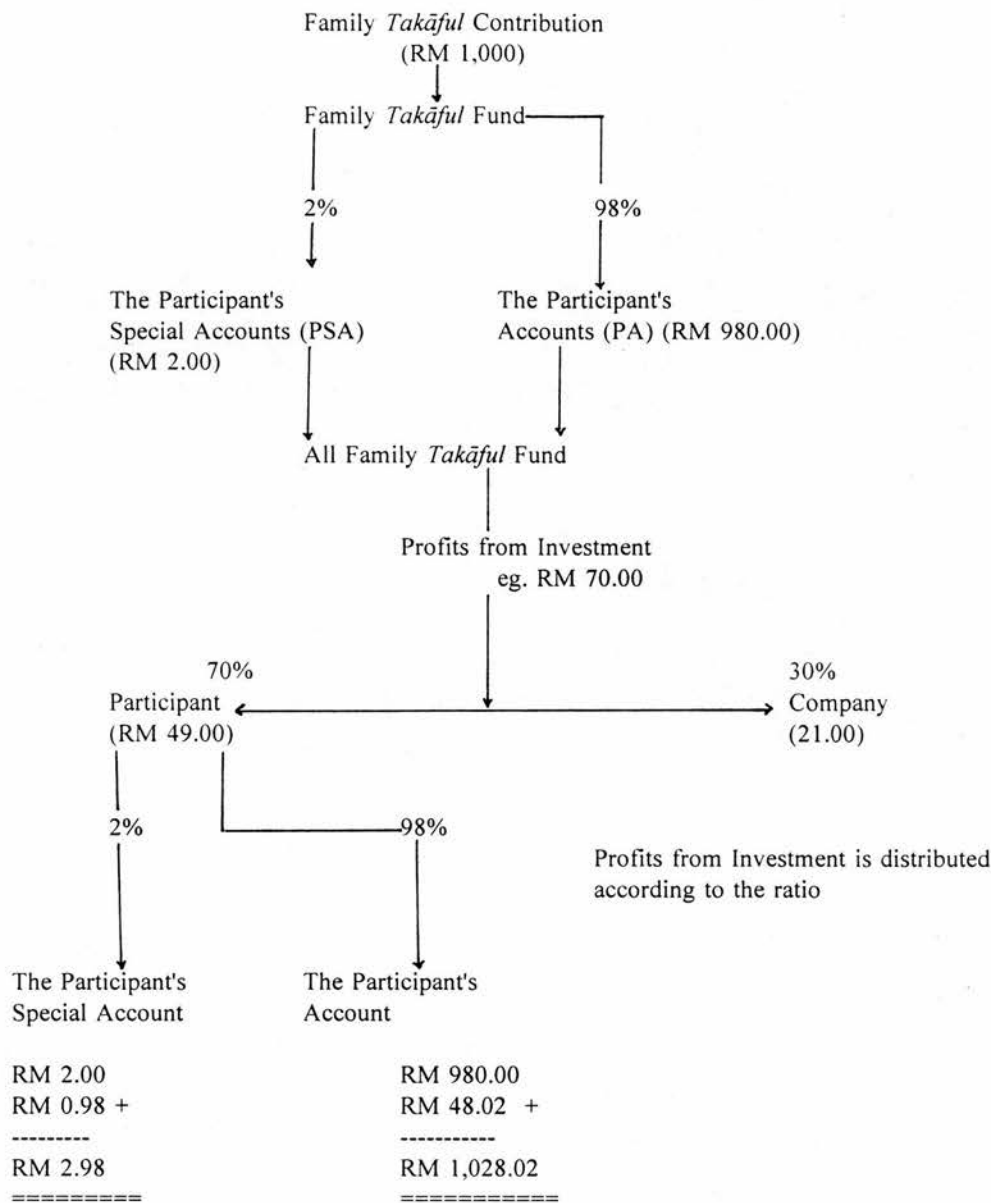
Source : STMSB, *Risalah Pelan Takāful Keluarga (a) and (b)*.

The *tabarru*^c proportion increases with the length of maturity of the Family *Takāful* Plan as well as with the age of the participant at entry. The factors determining the *tabarru*^c proportion in the Family *Takāful* Plans are the age at entry and the timeframe of the contract.⁶¹ In this regard, the instalment (contribution) remains the same but the *tabarru*^c proportion rises.⁶² It can be said that the purpose of the *tabarru*^c proportion that goes into the PSA account is to create a form of mutual fund, whilst that the PA serves to accumulate savings.

⁶¹ These factors are the same as those determining for the annual cost of a term assurance policy in conventional insurance. In Conventional Insurance, the premium rate rises both with age at entry and the length of the maturity period.

⁶² Mohd. Fadzli Yusuf (1991), p. 90; See also Nik Ramlah N. Mahmood, *op. cit.*, p. 288.

Figure 4.1 Family *Takāful* Contribution (Instalment)



Source : *Syarikat Takaful, Risalah Pelan Takaful Keluarga*, n. d.

One of the functions of the *Syarikat Takaful* in managing the Family *Takāful* business is the investment of the *takāful* instalments in line with the principle of *muḍārabah* or profit and loss sharing. The instalments credited into the two accounts,

i.e. PA and PSA accounts, are pooled as a single fund as shown in Figure 4.1. Therefore, monies from both the accounts are invested by *Syarikat Takāful* on a profit and loss sharing basis in enterprises which are not contrary to Islamic law either in their operations or in nature of their business. The profits generated from the investment are shared between the participants and *Syarikat Takāful* in a ratio mutually agreed between them. For example, a participant in the age group of 18 - 25 taking up a 10 years plan under Family *Takāful* Plan might have 2.0 per cent in PSA and 98 per cent in PA. The distribution of profits realized from investment by *Syarikat Takāful* is first divided according to the profit-sharing agreement, for example 70 : 30, between the participant and *Syarikat Takāful* respectively. The proportion (30 per cent) of the profits allocated to *Syarikat Takāful* goes into the profit and loss sharing account of *Syarikat Takāful*, while the profit accruing to the participant (70 per cent) is then distributed proportionately between his PA and PSA.⁶³ In other words, 2.0 per cent of the profits will go into his PSA and the remaining 98 per cent will go into PA as clearly shown in Figure 4.1.

In the case of loss of the investments of the Family *Takāful* Fund, however, it was recommended by the Report of the Committee⁶⁴ that it should be borne by the *Syarikat Takāful* alone as part of its operating costs, to be paid from the following year's profits. This departure from the Islamic principle of *muḍārabah* contract which requires both the participants and *Syarikat Takāful* to share not only the profits of the investments, but also in its losses, was thought to be necessary because the prospect, however minimal, of losing all or part of their investments might deter people from

⁶³ *Risalah Pelan Takāful Keluarga (b)*.

⁶⁴ *Report of the Committee on the Setting-up of an Islamic Insurance Company in Malaysia*.

participating in this scheme.

Family *Takāful* benefits ⁶⁵

Under the Family *Takāful* Plan, the *takāful* benefits shall be paid to the participants or their heir(s) upon the occurrence of any of the following cases:

- Case one (1) : the participant survives the maturity of his *takāful* plan.
- Case two (2) : the participant dies before the maturity of his *takāful* plan.

In the first case, he shall be paid the total amount of *takāful* instalments paid by the participant during the period of his participation and all the profits, if any, from the investment of the *takāful* instalments credited into his PA.⁶⁶

In the second case, the *takāful* benefits to be paid to the heir(s) or proper claimant⁶⁷ is all the money in the participant's PA as at the time of his death.⁶⁸ This includes all his contributions until the time of his death and all the profits that his contributions have earned and credited into his PA over the same period. This amount, however, will inevitably be less than the amount which the participant would

⁶⁵ According to S. 2 *Takāful Act 1984*, *takāful* benefits includes any benefit, pecuniary or not which is secured by a *takāful* certificate, and "pay" and other expressions, where used in relation to *takāful* benefits, shall be construed accordingly.

⁶⁶ STMSB, *Pelan Takāful Keluarga (a) and (b)*.

⁶⁷ S. 65 (4) *Takāful Act 1984* provides : "Proper claimant means a person who claims to be entitled to the sum in question as executor of the deceased, or who claims to be entitled to that sum under the relevant law".

⁶⁸ The *takāful* benefit is to be paid to a proper claimant without the need for the production of any probate or letters of administration. See S. 65 (1) *Takāful Act 1984*.

have expected to get if he survived until the maturity of his plan. The difference between these two cases is that his heir(s) will be paid the outstanding *takāful* amounts which would have been paid by the deceased into his PSA should he have survived. This amount is calculated from the date of death to the date of maturity of his Family *Takāful* Plan. Through the instrumentality of the PSA, therefore, a participant in the Family *Takāful* is able to determine the amount (subject only to variations of profits) that either he or his heir(s) would get as *takāful* benefits.⁶⁹

If the participant decides to withdraw his participation before the maturity date of his Family *Takāful* Plan, he shall be able to surrender benefits,⁷⁰ that is all his *takāful* instalments which have been credited into his PA with the profits which those instalments have earned so far. His contribution to the PSA is a form of donation which he has agreed to make and it is not returned.⁷¹

(b) General *Takāful* Schemes⁷²

The General *Takāful* is a scheme which provides cover for an individual or a body corporate against losses or damage consequent upon a catastrophe or disaster such as fire, flood and accident, usually inflicted upon properties or assets. The main

⁶⁹ STMSB, *Pelan Takāful Keluarga (a) and (b)*.

⁷⁰ There is no minimum period of payment of *takāful* instalments after which the participant is entitled to surrender benefits, while in the conventional insurance, the insured becomes entitled to surrender benefits only if he has paid his premium instalments for a minimum period, for example three years. There is no forfeiture in the Family *Takāful* Plan. Syed Waseem Ahmad, *op. cit.*, p. 196.

⁷¹ M. F. Yusuf, "*Takāful Insurance Company Malaysia Sdn. Bhd.*", p. 91; see also N. R. Mahmood, *op. cit.*, pp. 289 - 290.

⁷² See s. 3 (1) (ii), *Takaful Act 1984*.

types of the General *Takāful* schemes are, among others, General *Takāful* Schemes for motor vehicles, fire and theft, accidents and marine.⁷³

A participant in this scheme also enters in a *muḍārabah* contract with *Syarikat Takāful*. The contract stipulates the amount which the participant has to contribute under the scheme. Like the amount of premium in general insurance, this amount is determined by *Syarikat Takāful* which takes into account factors such as the value of the property and the risk involved.⁷⁴ The term of participation or the period of *takāful* in respect of the General *Takāful* Schemes is usually for a span of one year. On expiry of the period of *takāful*, the term may be renewed for another one-year period.⁷⁵

Unlike the Family *Takāful* Plans, the General *Takāful* Schemes are not structured to function as a means of savings, although the participants are entitled to some form of profit sharing as expressed in the principle of *muḍārabah*. However, under the General *Takāful* Schemes, the entire contributions are paid as *tabarruʿ* for the purpose of creating defined assets or funds (General *Takāful* Fund) to pay against a defined loss. Part of the *tabarruʿ* funds are used to cover the expenses of the scheme. The remainder is invested by *Syarikat Takāful* in the same way, subject to the same restriction as the investment of funds from the Family *Takāful*. All the profits from such investments are returned to the Fund.

⁷³ STMSB, *Risalah Perlindungan Takāful*.

⁷⁴ In the determination of General *Takāful* contributions, the same principle, methods and technique apply as in the case of conventional insurance. The difference from conventional insurance lies in sharing the surplus (profits) after deducting all operational costs such as re-*takāful*. See Syed Waseem Ahmad, *op. cit.*, p. 197.

⁷⁵ STMSB, *Risalah Perlindungan Takāful*.

In line with the virtue of solidarity, mutual help, shared responsibility and joint guarantee as embodied in the concept of *takāful*, *Syarikat Tākāful* (Company) as the manager (operator) or trustee of the Fund, shall pay from this Fund any benefits, compensation or indemnity to any participant who suffers a defined loss or damage consequent upon the occurrence of a catastrophe or disaster. All operational costs for managing the General *Takāful* business such as the cost of re-*takāful* (re-insurance) and setting-up of reserves shall be borne by the Fund. If, at the end of the financial year, there is a surplus, it is shared between *Syarikat Takāful* and the participants who have not made any claims under their respective plans. The sharing of the surplus will be made according to a ratio agreed to in advance in accordance with the principle of *muḍārabah* such as 6 : 4, 5 : 3, 5 : 5, etc.⁷⁶ This provides a form of incentive to the participants along the line provided by the No Claims Bonus (NCB) in motor insurance.

4.4. *Syarikat Takaful* As A Financial Institution : An Evaluation of Performance

4.4.1. Family *Takāful* Fund

(a) Contributions of Family *Takāful* Fund

Table 4.2 provides statistics relating to the operations of the Family *Takāful* Fund of various plans and mortgages which consist of gross Family *Takāful* contributions, new business contributions, net Family *Takāful* contributions after deduction of the total operational costs and total (cumulative) net Family *Takāful*

⁷⁶ *Risalah Perlindungan Takāful*; N. R. Mahmood, *op. cit.*, p. 290; Syed Waseem Ahmad, *op. cit.*, p. 197; M. F. Yusuf (1991), *op. cit.*, pp. 91 - 92.

contributions at the end of the year during the first six years of *Syarikat Takāful*'s operations. Table 4.3, presents statistics relating to the details of the operational costs incurred by *Syarikat Takāful* during the first six years of its operations.

During the first six financial years, the gross Family *Takāful* contributions increased to 868 per cent or RM 1,092,566 in 1987, 93.9 per cent or RM 2,118,272 in 1988 and 144.6 per cent or RM 5,181,673 in 1989. However, the annual growth of the gross Family *Takāful* contributions decreased to 22 per cent and 4.9 per cent in 1990 and 1991 respectively. It is noteworthy to note that the largest proportion of the gross Family *Takāful* contributions were formed from the new business contribution. For example, during the 1989 financial year, a sum of RM 3,707,381 or 71.5 per cent of the total gross Family *Takāful* contributions was from new business.

Operational costs for Family *Takāful* Fund consist of re-*takāful* or refunds, claims (paid and outstanding), surrenders and levies. In the first year, there were no claims. Consequently, the operational costs (RM 13,922) formed only 2.3 per cent of the gross Family *Takāful* contributions. In the second year, operational costs rose to RM 109,221 which constituted about 10 per cent of the gross Family *Takāful* contributions. During the third financial year, the operational costs rose further to RM 245,897 or 11.62 per cent of the gross Family *Takāful* contributions. However, during the 1989 financial year, these costs declined to 8 per cent of the gross Family *Takāful* contributions, and rose again to RM 677,916 and RM 1,080,753, representing 10.7 per cent and 16.3 per cent in the financial years 1990 and 1991 respectively. As depicted in Table 4.3 below, the significant rise of these costs is obviously due to an increase in surrenders that accounted for 81 per cent and 82 per cent in the financial

years 1987 and 1988 respectively. During 1989, the total operational costs constituted about 8 per cent. Although the cost of surrender rose to 84.64 per cent in 1989 compared with 82 per cent in the previous year, the cost of claims paid and outstanding declined to 5.80 per cent from 10.4 per cent previously. During the financial years 1990 and 1991, the total operating costs rose again to 10.6 per cent and 16.3 per cent of the gross Family *Takāful* contributions respectively because of the rise of costs of both re-*takāful* and claims. In the case of re-*takāful*, it represents 8.8 per cent and 9 per cent, while the cost of claims constitute 10.7 per cent and 16.3 per cent of the total operational costs.

After deducting the operational costs, the net Family *Takāful* contributions retained at the end of the 1989 financial year rose to RM 4,768,553 from RM571,076 in the previous year. At the end of the 1990 and 1991 financial years, the net Family *Takāful* contributions reached RM 5,646,595 and RM 5,555,292 respectively. The cumulative figure of net Family *Takāful* contributions at the end of the sixth financial year amounted to RM 19.4 million from RM 14 million in the previous year, an increase of about 40.2 per cent.

Table 4.2**Contributions of the Family *Takāful* Fund (in RM = Malaysian Ringgit)**

	1986	1987	1988	1989	1990	1991
1 (RM)	584,998	1,092,566	2,118,272	5,181,673	6,324,511	6,636,045
%	100	100	100	100	100	100
AG (%)	-	869	93.9	144.6	22	4.9
2 (RM)	na	na	1,171,913	3,707,381	4,516,619	3,267,956
%			55.37	71.5	71.4	49.2
3 (RM)	13,922	109,221	245,897	413,120	677,916	1,080,753
%	2.4	10	11.6	8	10.7	16.3
4 (RM)	571,076	983,345	1,872,375	4,768,553	5,646,595	5,555,292
%	97.6	90	88.4	92	89.3	83.7
5 (RM)	-	1,554,421	3,426,796	8,165,373	13,811,968	19,367,260
AG (%)		-	120.5	138.3	69	40.2

Notes:

1 = gross Family *Takāful* contributions 2 = new business 3 = operational costs4 = net Family *Takāful* contributions 5 = cumulative net Family *Takāful* contributions

AG = annual growth

Source : Compiled from *Annual Reports of Syarikat Takaful 1986 - 1991*.**Table 4.3****Family *Takāful*'s Operational Costs (in RM = Malaysian Ringgit)**

	1 RM	%	2 RM	%	3 RM	%	4 RM	%	5 RM	%
1986	4,979	35.8	6,018	43.2	-		2,925	21	13,922	100
1987	9,936	9.1	88,411	81	5,410	4.9	5,464	5	109,221	100
1988	8,352	3.4	201,696	82	25,458	10.4	10,391	4.2	245,897	100
1989	19,131	4.63	345,542	83.64	23,955	5.80	24,492	5.93	413,120	100
1990	59,708	8.8	535,614	79	51,006	7.5	31,588	4.7	677,916	100
1991	97,023	9.0	648,874	60	302,058	28	32,798	3	1,080,753	100

Notes: 1 = *retakāful* 2 = surrenders 3 = claims paid and outstanding

4 = levies 5 = total operational costs

Source : Compiled from *Annual Reports of Syarikat Takaful 1986 - 1991*.

(b) Investments of the Family *Takāful* Fund and profits attributable to the Company and participants

Table 4.4

Profits from Investments of Family *Takāful* Funds (in RM = Malaysian Ringgit)

Items	1986	1987	1988	1989	1990	1991
1	-	-	3,018	13,970	25,996	10,161
%	-	-	2.3	5.1	6.6	1.0
Ranking	-	-	6	6	6	6
2	-	-	4,252	34,593	51,091	200,090
%	-	-	3.2	12.5	13	19.0
Ranking	-	-	5	3	4	2
3	6,011	51,018	58,705	118,816	158,699	533,021
%	100	69.5	44.8	43	40.4	50.6
Ranking	1	1	1	1	1	1
4	-	520	12,000	28,565	57,600	93,318
%	-	0.7	9.2	10.34	14.7	8.9
Ranking	-	3	4	4	3	4
5	-	21,835	35,842	65,991	64,830	154,945
%	-	29.6	27.3	23.9	16.5	14.7
Ranking	-	2	2	2	2	3
6	-	-	17,309	14,299	34,415	61,517
%	-	-	13.2	5.2	8.8	5.8
Ranking	-	-	3	5	5	5
Total	6,011	73,373	131,126	276,234	392,631	1,053,052
%	100	100	100	100	100	100
AG (%)	-	112.6	78.7	110.7	42.1	168.2

Notes:

1 = dividend income from shares quoted in Malaysia 2 = income from term financing

3 = income from Investment Accounts with Holding Company (*Bank Islam Malaysia Berhad*)

4 = income from Malaysian Government Investment Certificates 5 = profit on disposal of shares quoted

in Malaysia 6 = profit on disposal of Malaysian Government Investment Certificates

Source : Compiled from *Annual Reports of Syarikat Takaful 1986 - 1991*.

The Family *Takāful* Fund is invested in the following type of investments:

1. investment in Investment Accounts with *Bank Islam Malaysia Berhad*

2. purchase of shares quoted in Malaysia
3. purchase of Malaysian Government Investment Certificates
4. investment in term financing.

As shown in Table 4.4 above, the Family *Takāful* Fund's investments during the first six years of *Syarikat Takāful*'s operations contributed six types of major income, namely:

1. dividend income from shares quoted in Malaysia
2. income from term financing
3. income from Investment Accounts with *BIMB*
4. income from Malaysian Government Investment Certificates
5. profit on disposal of shares quoted in Malaysia
6. profit on disposal of Malaysian Government Investment Certificates.

As presented in Table 4.4 above, profit from the investments of the Family *Takāful* Fund increased from RM 6,011 in 1986 to RM 73,373 in 1987, RM 131, 126 in 1988, RM 276,234 in 1989, RM 392,631 in 1990 and RM 1,053,052 in 1991. As shown in Table 4.5 below and following the profit-sharing ratio of 70 : 30 agreed to in the *muḍārabah* contract between the participants and the Company, 30 per cent of the profit (RM 1,803 in 1986, RM22,012 in 1987, RM 36,338 in 1988, RM 82,870 in 1989, RM 117,790 in 1990 and RM 315,916 in 1991) was transferred to the profit sharing and loss account of *Syarikat Takāful*, and the remaining 70 per cent (RM 4,208 in 1986, RM 51,361 in 1987, RM 91,788 in 1988, RM 193,364 in 1989, RM 274,842 in 1990 and RM 737,137 in 1991) was credited to the participants' accounts (Family *Takāful* Fund).

Table 4.5**Family *Takāful* Plans and Mortgages : Profits Attributable to the company and participants**

	Company	%	Participants	%	Total	%
1986 : RM	1,803	30	4,208	70	6,011	100
1987 : RM	22,012	30	51,361	70	73,373	100
1988 : RM	39,338	30	91,788	70	131,126	100
1989 : RM	82,870	30	193,364	70	276,234	100
1990 : RM	117,790	30	274,842	70	392,632	100
1991 : RM	315,915	30	737,137	70	1,053,052	100

Source : *Syarikat Takaful Malaysia Sendirian Berhad, Annual Reports 1986 - 1991; idem, Laporan*

Tahunan Ketujuh Ketua Pengarah Takaful, 1991, p. 10.

4.4.2. Group Family *Takāful* Fund

(a) Contributions of Group Family *Takāful* Fund

Syarikat Takaful has been operating the Group Family *Takāful* plan since the 1989 financial year. Table 4.6 below, provides statistics relating to the Group Family *Takāful* Business, which include gross Group Family *Takāful* contributions, total operational costs and underwriting surplus (profit), while Table 4.7 below provides statistics relating to the details of operational costs incurred by the Group Family *Takāful* Fund consisting of payment of re-*takāful*, reserves for unearned *takāful* contributions, claims (paid and outstanding) and levies.

During the first three years of operations, the gross Group Family *Takāful* Fund amounted to RM 852,500 in 1989, RM 1,633,574 in 1990 and RM 2,167,932 in 1991. The annual growth of the Group Family *Takāful* Fund was 91.6 in 1990 and 32.7 in 1991. After taking into account the operational costs comprising payment for re-*takāful*, reserves for unearned *takāful* contributions, claims paid and outstanding

and levies, underwriting profit is arrived at. The underwriting profit for the second financial year was RM 292,520 as against RM 121,690 in the previous year. In the third financial year, the underwriting profits recorded a growth of 177.2 per cent, reaching RM 810,740. The increase of the surplus (underwriting profit) was as a result of a decrease of the total operational costs to 62.6 per cent of the gross contributions in 1991 from 82.1 per cent previously. As presented in Table 4.7 below, the decrease of the total operational costs in 1991 was due to the decrease of the reserve for unearned Group Family *Takāful* contributions from RM 123,552 in 1990 to RM 15,220 in 1991, or from 9.2 per cent to 1.1 per cent of the total operational costs in 1990 and 1991 respectively.

Table 4.6

Contributions of Group Family *Takāful* Plan (in RM = Malaysian Ringgit)

Items	1989 RM	%	AG	1990 RM	%	AG	1991 RM	%	AG
1. Gross Contributions	852,560	100	-	1,633,574	100	91.6	2,167,193	100	32.7
2. Operating Costs	730,870	85.7	-	1,341,054	82.1	-	1,357,192	62.6	-
3. Underwriting Profits	151,666*	14.3	-	292,520	17.9	48.2	810,740	37.4	177.2
4. Total Percentage	100			100			100		

Notes:

AG = annual growth

* Including RM 29,976 transfered from Family *Takāful* Fund

Source : *Syarikat Takaful Malaysia Sendirian Berhad, Annual Reports 1989 - 1991.*

Table 4.7Operational Costs of Group Family *Takāful* Funds (in RM = Malaysian Ringgit)

Items	1989 RM	%	1990 RM	%	1991 RM	%
1	178,511	24.4	109,129	8.1	133,757	9.9
2	143,260	19.6	123,552	9.2	15,220	1.1
3	405,135	55.4	1,100,355	82.1	1,197,343	88.2
4	3,964	0.5	8,018	0.6	10,872	0.8
5	730,870	100	1,341,054	100	1,357,192	100

Notes:

1 : *retakāful* 2 : reserve for unearned *takāful* contributions

3 : claims paid and outstanding 4 : levies

5 : total operational costs

Source : *Syarikat Takaful, Annual Reports 1989 - 1991*.**(b) Income from investments**

During the first three years of its operations, the Group Family *Takāful* Fund was invested mainly in the Investment Accounts of *Bank Islam Malaysia Berhad*, and with term financing only in the 1991 financial year. As presented in Table 4.8 below, the returns on investments of the fund during the 1990 financial year amounted to RM 18,515 as against RM 2,255 in the previous year. In the 1991 financial year, the return of investments reached RM 46,006, an increase of 148.5 per cent over 1990.

Underwriting profits and income realized from investments of the fund constituted the total income of the Group Family *Takāful* Fund as depicted in Table 4.8 below. During the 1990 financial year, total income increased to RM 311,035 from RM 153,921 previously. In the third financial year, it reached RM 856,746, an

increase of 175.5 per cent over 1990.

Table 4.8

Group Family *Takāful*'s Income (in RM = Malaysian Ringgit)

Items	1989	%	1990	%	1991	%
Underwriting Income (RM)	151,666	98.5	292,520	94.0	810,740	94.63
Annual Growth (%)			48.2		177.2	
Income From Investments:						
1. BIMB (RM)	2,255	1.5	18,515	6.0	35,381	4.13
2. Term Financing (RM)	-		-		10,625	1.24
Total (RM)	2,255		18,515		46,006	
Annual Growth (%)	-		721.1		148.5	
Total Income (RM)	153,921	100	311,035	100	856,746	100
Annual Growth (%)	-		102.1		175.5	

Source : *Syarikat Takaful Malaysia Sendirian Berhad, Annual Reports 1989 - 1991.*

(c) Profits attributable to the Company and participants

In accordance with the profit-sharing contract of *muḍārabah* between *Syarikat Takaful* and the participants, and as presented in Table 4.9 below, during the 1989 and 1991 financial years, 50 per cent of the profits were attributable to the Company and the participants respectively. However, in the 1990 financial year, 82.4 and 17.6 per cent of the profits were attributable to the Company and the participants respectively.

Table 4.9

Group Family *Takāful* Plan : Profits Attributable to the Company and participants (in RM = Malaysian Ringgit)

	1989		1990		1991	
	RM	%	RM	%	RM	%
Company	76,960	50	256,411	82.4	428,373	50
Participants	76,961	50	54,624	17.6	428,373	50
Total	153,921	100	311,035	100	856,746	100

Source : *Syarikat Takaful Malaysia Sendirian Berhad, Annual Reports 1986 - 1991; Idem, Laporan*

4.4.3. General *Takāful* Fund

(a) Contributions of General *Takāful* Fund

Table 4.10

Contributions of General *Takāful* Fund (in RM = Malaysian Ringgit)

	GC RM	%	AG%	TOC RM	%	UP RM	%	AG %
1986	1,406,766	100		1,074,149	76.4	332,617	23.6	-
1987	4,690,558	100	233.4	3,195,186	68.1	1,495,372	31.9	349.6
1988	9,723,184	100	107.3	7,038,762	72.4	2,684,422	27.6	79.5
1989	16,516,474	100	70.0	11,207,886	67.9	5,308,588	32.1	97.8
1990	20,320,930	100	23.0	13,600,215	66.9	6,720,715	33.1	26.6
1991	25,657,356	100	26.3	18,507,580	72.1	7,149,776	27.9	6.4

Notes:

GC = gross contributions; TOC = total operational costs; UP = underwriting profits; AG = annual growth

Source : Compiled from *Annual Reports of Syarikat Takaful* 1986 - 1991.

Table 4.11

General *Takāful* Fund : Operational Costs (in RM = Malaysian Ringgit)

year	1	2	3	4	5	TOC
1986	413,149	549,642	102,864	6,463	2,031	1,074,149
%	38.46	51.17	9.58	0.60	0.19	100
1987	991,836	1,301,089	878,063	24,198	-	3,195,186
%	31.04	40.72	27.48	0.76		100
1988	1,643,091	2,132,309	3,211,478	51,884	-	7,038,762
%	23.34	30.29	45.63	0.74		100
1989	2,888,465	1,965,251	6,245,661	108,509	-	11,207,886
%	25.77	17.53	55.73	0.97		100
1990	2,919,376	1,398,531	9,122,366	159,344	598	13,600,215
%	21.47	10.28	67.08	1.17	0.004	100
1991	3,344,689	2,132,181	12,814,718	215,992	-	18,507,580
%	18.07	11.52	69.24	1.17		100

Notes:

1 = Retakāful or refund; 2 = Reserve for unearned *takāful* contributions;

3 = Claims (paid and outstanding); 4 = Levies; 5 = Others; TOC = Total Operational Costs.

Source : Compiled from *Syarikat Takaful's Annual Reports 1986 - 1991*.

Table 4.10 above, provides statistics relating to the gross General *Takāful* contributions, total operational costs and underwriting profits, while Table 4.11 below presents statistics relating to the operational costs of the General *Takāful* Fund.

During the first six financial years, the gross General *Takāful* contributions increased from RM 1.4 million in 1986 to RM 4.7 million, RM 9.7 Million, RM 16.5 million, RM 20.3 million and RM 25.7 million in the 1987 to 1991 financial years respectively. However, the annual growth of the gross General *Takāful* contributions decreased from 233.4 per cent in 1987 to 26.3 per cent in 1991. As presented in Table 4.11 below, the operational costs for the General *Takāful* Fund consist of payment of re-*takāful* or refunds, reserve for unearned *takāful* contributions, claims (paid and outstanding), levies and others. During the first six financial years, the total operational costs were fluctuating between 67 per cent to 68.1 per cent of the gross General *Takāful* contributions. In the first year of operation, reserve for unearned *takāful* contributions contributed the largest portion of the total operational costs, i. e. 51.17 per cent. However, in the 1991 financial year, 69.24 per cent of the total operational costs was contributed by claims (paid and outstanding).

After deducting payment of the total operational costs, the underwriting profits are arrived at as presented in Table 4.10. During the first six financial years, the percentage of the underwriting profits of General *Takāful* contributions were

fluctuating between 24 per cent to 33.1 per cent. However, the amounts of the underwriting profits increased from RM 332, 617 in the 1986 financial year to RM 7, 149, 776 in the 1991 financial year. During the first six financial years, the annual growth of the underwriting profits of General *Takāful* contributions was decreasing from 349.6 per cent to 6.4 per cent. The highest annual growth of underwriting profits was recorded in the 1987 financial year, i. e. 349. 6 per cent, because the amount of the underwriting profits increased from RM 332,617 in 1986 to RM 1,495,372 in 1987.

(b) General *Takāful* Fund's investments

Table 4.12 below provides statistics relating to the returns of various General *Takāful* Fund's investment. During the first six years of operations, General *Takāful* Fund has been invested into four types of investments as follows:

- 1: investment accounts with *Bank Islam Malaysia Berhad*
2. investment in term financing
3. purchase of shares quoted in Malaysia
4. Purchase of Malaysian Government Investment Certificates.

As presented in Table 4.12 below, the General *Takāful* Fund received six main types of income from its investments, namely:

1. dividend income from shares quoted in Malaysia
2. income from term financing
3. income from Investment Accounts with *Bank Islam Malaysia Berhad*
4. income from Malaysian Government Investment Certificates
5. profit on disposal of shares quoted in Malaysia

6. profit on disposal of Malaysian Government Investment Certificates.

Table 4.12

General Takāful Fund : Income from Investments (in RM = Malaysian Ringgit)

	1986 R	1987 R	1988 R	1989 R	1990 R	1991 R
1 %	-	-	6,338 1.5	8,881 1.5 6	23,921 2.6 7	10,046 0.7 7
2 %	-	-	17,014 4.0 5	118,991 19.9 3	165,614 18.2 2	386,612 28.6 2
3 %	8,576 100 1	105,069 85.6 1	195,309 46.3 1	228,788 38.3 1	448,602 49.3 1	667,390 49.4 1
4 %	-	520 0.4 3	24,000 5.7 4	83,475 14.0 4	102,600 11.3 3	136,578 10.1 3
5 %	-	17,099 14 2	134,676 31.9 2	139,516 23.4 2	61,169 6.7 5	62,969 4.7 5
6 %	-	-	44,639 10.6 3	17,472 2.9 5	67,730 7.5 4	86,843 6.4 4
7 %	-	-	-	-	39,965 4.4 6	
8 Total %	8,576 100	122,688 100	421,976 100	597,123 100	909,601 100	1,350,438
AG (%)	-	1,330.6	243.9	41.5	52.3	48.5

Notes:

1 = dividend income from shares quoted in Malaysia

2 = income from term financing

3 = income from Investment Accounts with *BIMB*

4 = income from Malaysian Government Investment Certificates

5 = profit on disposal of shares quoted in Malaysia

6 = profit on disposal of Malaysian Government Investment Certificates

7 = other income 8 = total income from investments

AG = annual growth (%).

R = Ranking

Source : Compiled from *Annual Reports of Syarikat Takaful* 1986 - 1991.

During the first six years of operations of the General *Takāful* Fund, the total income from investments was derived mainly from the profit from the investment accounts with *Bank Islam Malaysia Berhad*. In other words, *BIMB* made the largest contribution to the total income from the investments of the fund. In the first year of investment, the General *Takāful* Fund received its only income from Investment Accounts with *BIMB*, i.e. was RM 8,576. Until the 1989 financial year, the second largest income was received from profit on disposal of shares quoted in Malaysia. However, in the 1990 financial year, income from term financing constituted the second largest share of total income of the fund's investments. The remaining income was derived from the other sources, i. e. dividend income from shares quoted in Malaysia, income from term financing, income from Malaysian Government Investment Certificates, profit on disposal of shares quoted in Malaysia and profit on disposal of Malaysian Government Investment Certificates. Returns on investments of the fund during the 1991 financial year amounted to RM 1,350,438 as against RM 909,601 in the previous year, an increase of 48.5 per cent over 1990.

(c) General *Takāful* income and profits attributable to the Company and participants

Underwriting profit and income realized from investments of the fund formed the total profit accruing to the Company and the participants in accordance with *muḍārabah* principles. As presented in Table 4.13 below, during the first six years of operations of the General *Takāful* Fund, income derived from underwriting profit constituted more than 84 per cent of the total income that accrued to both the Company and the participants. The remaining proportions of total income were received from the profits of the fund's investments. The data from Table 4.13 below

shows that the amounts of the total income increased from RM 241,562 in 1986 to RM 1,618,060 in 1987, RM 3,106,398 in 1988, RM 5,905,711 in 1989, RM 7,630,316 in 1990 and RM 8,500,214 in 1991. However, the annual growth of the total income was seen to be declining from 398.5 per cent in 1987, to 92 per cent in 1988, 90.1 per cent in 1989, 29.2 per cent in 1990 and 11.4 per cent in 1991.

Table 4.13

General *Takāful* Income (in RM = Malaysian Ringgit)

	Underwriting Profits		Income From Investments		Total Income RM %		Annual Growth(%)
	RM	%	RM	%			
1986	315,986	97.4	8,576	2.6	241,562	100	-
1987	1,495,372	92.4	122,688	7.6	1,618,060	100	398.5%
1988	2,684,422	86.4	421,976	13.6	3,106,398	100	92%
1989	5,308,588	98.9	597,123	10.1	5,905,711	100	90.1%
1990	6,720,715	88.0	909,601	12.0	7,630,316	100	29.2%
1991	7,149,776	84.1	1,350,438	15.9	8,500,214	100	11.4 %

Source : Compiled from *Annual Reports of Syarikat Takaful 1986 - 1991*.

Table 4.14

General *Takāful* Fund : Profits attributable to the Company and participants (in RM = Malaysian Ringgit)

Year	Company RM %		Participants RM %		Total RM %	
1986	129,825	40.0	194,737	60.0	324,562	100
1987	647,224	40.0	970,836	60.0	1,618,060	100
1988	1,258,603	40.5	1,847,795	59.5	3,106,398	100
1989	2,864,124	48.5	3,041,587	51.5	5,905,711	100
1990	3,815,158	50.0	3,815,158	50.0	7,630,316	100
1991	4,280,220	50.4	4,219,994	49.6	8,500,214	100

Source : *Syarikat Takaful Sendirian Berhad, Laporan Tahunan Ketujuh Ketua Pengarah Takaful 1991*, p.

15.

In line with the profit-sharing contract of *mudārabah* between the Company and

the participants, at the end of a financial year, a certain ratio of profit is transferred to the participants' General *Takāful* Fund. The remaining profits are credited to the Company's General *Takāful* Fund. As was noted earlier, 60 per cent of the total profits goes to the participants and the remaining 40 per cent to the Company. However, in practice, as presented in Table 4.14 above, during the first six years of General *Takāful* operations, the ratios of profit attributable to the participants varied from 49.6 per cent to 60 per cent, while 40 to 50.4 per cent was attributable to the Company. In 1991, *Syarikat Takaful* transferred RM 4,219,994, or 49.6 per cent of the total General *Takāful*'s income, to the General Takaful Fund as profit attributable to the participants as against RM 3,815,158 in the preceding year. The remaining 50.4 per cent of the total income was transferred to the Company's General *Takāful* Fund.

4.4.4. Performance of *Syarikat Takaful*

Syarikat Takaful has done well in the first six years of its operations. The performance of *Syarikat Takaful* can be seen under the following headings:

(a) Branch network and employment structure

During the 1991 financial year, *Syarikat Takaful* successfully opened seven (7) branches in seven (7) major towns in Malaysia, i. e. Kota Bharu, Kuala Terengganu, Kuantan, Alor Setar, Ipoh, Melaka and Johor Bahru. In line with the Company's commitment to expand its services, a total of eight *Takāful* Desks were opened at selected branch offices of *BIMB* and *Tabung Haji* during the 1991 financial year. Hence, at the end of 1991, there were a total of thirty seven (37) *Takāful* Desks:

twenty one at the branch offices of *Bank Islam* and sixteen at the district offices of *Tabung Haji* has been opened.⁷⁷

As presented in Table 4.15 below, at the end of the 1991 financial year, the Company's total staff strength increased to 176 consisting of 37 executives at all levels and 139 in clerical and non-clerical grades.⁷⁸ The total of staff strength at the end of the previous year was 146, consisting of 31 executives at all levels and 115 in clerical and non-clerical grades, an increase of 21.2 per cent as against 8.1 per cent in the previous year.⁷⁹

Table 4.15

Syarikat Takaful : Staff Recruitment and Development 1988 - 991.

Year	Executives	Clerical and Non-Clerical	Total	Annual Growth %
1988	26	60	86	—
1989	33	102	135	57
1990	31	115	146	8.1
1991	37	139	176	21.2

Source : *Syarikat Takaful, Annual Reports 1986 - 1991.*

(b) Total financing

The activities of the Company have been financed by the shareholders' fund, the Family *Takāful* Fund, the Group Family *Takāful* Fund (which started in the 1989

⁷⁷ *Syarikat Takaful, Laporan Tahunan 1991*, pp. 6 - 7.

⁷⁸ *Syarikat Takaful, Laporan Tahunan 1991*, p. 7.

⁷⁹ *Ibid, Laporan Tahunan 1990*, p. 7.

financial year), and the General *Takāful* Fund. As presented in Table 4.16 below, after taking account of accumulated losses in the initial year, the shareholders' fund stood at RM 9.8 million at 30 June 1988, compared with RM 9.4 million a year earlier. During the 1989, 1990 and 1991 financial years, *Syarikat Takāful*'s shareholders's fund amounted to RM 10.4 million, RM 11 million and RM 12.3 million respectively. With the increased share of the Family *Takāful* Fund and the General *Takāful* Fund in financing, the proportion of the Shareholders's Fund in the total amount of financing has annually decreased from 87.6 per cent in 1986, to 69 per cent in 1987, 52.13 per cent in 1988, 38.3 per cent in 1989, 31.4 per cent in 1990 and 27 per cent in 1991. As shown in Table 4.19 below, the increased share of the Family *Takāful* Fund in financing can be seen, for example, in the 1991 financial year, when the Family *Takāful* Fund contributed 45 per cent of the total financing activities of *Syarikat Takāful*, as against 41.05 per cent in the previous year.

Table 4.16

***Syarikat Takāful* : Proportion of Shareholders, Family *Takāful*, Group Family *Takāful* and General *Takāful* Funds in financing 1986 - 1991 (in Malaysian Ringgit).**

Year	SF (RM)	FTF (RM)	GFTF (RM)	GTF (RM)	Total (RM) Total %	Annual Growth
1986 %	9,423,552 87.6	575,284 5.3	-	761,010 7.1	10,759,846 100	-
1987 %	9,422,372 69	1,609,990 11.8	-	2,621,665 19.2	13,654,027 100	27.1
1988 %	9,769,729 52.13	3,568,447 19.04	-	5,400,606 28.82	18,738,782 100	37.21
1989 %	10,447,814 38.3	8,490,310 31.2	220,221 0.8	8,090,508 29.7	27,248,853 100	37.21
1990 %	11,005,855 31.4	14,394,143 41.1	389,423 1.1	9,274,404 26.4	35,063,825 100	28.7
1991 %	12,301,775 27	20,661,953 45.3	811,218 1.8	11,812,544 25.9	45,587,490 100	30

Notes: SF = Shareholders' Fund; FTF = Family *Takāful* Fund; GFTF = Group Family *Takāful* Fund; GTF = General *Takāful* Fund

Source : *Syarikat Takaful Malaysia Sendirian Berhad, Balance Sheets 1986 - 1991.*

The annual growth of total financing of *Syarikat Takaful* increased by 27.1 per cent in the second year, 37.21 per cent in the third year, 45.4 per cent in the fourth year, decreased to 28.7 per cent in the fifth year and slightly increased to 30 per cent in the sixth year of its operations.

(c) *Syarikat Takaful's* investments

Syarikat Takaful derives its income from the profits of the investment of its Shareholders' Fund in line with the profit-sharing contract of *mudārabah*, as well as from the management of all the Family *Takāful* Funds, the Group Family *Takāful* Funds and the General *Takāful* Funds. The Shareholders's Funds are invested by *Syarikat Takaful* in the following type of investment:

1. investment in term financing
2. investment accounts with *Syarikat Takaful's* holding company, i. e. *Bank Islam Malaysia Berhad*
3. purchase of shares quoted in Malaysia
4. investment in fixed assets.

As presented in Table 4.17 below, *Syarikat Takaful* receives five types of major incomes derived by its investments of the Shareholders' Fund as follows:

1. income from term financing
2. income from Investment Accounts with *Bank Islam Malaysia Berhad*

3. dividend income from shares quoted in Malaysia
4. profit on disposal of shares quoted in Malaysia
5. rental income from holding company and other.

Table 4.17

Syarikat Takaful : Income from the investments of the Shareholders' Fund (in RM = Malaysian Ringgit)

Year	1 R	2 R	3 R	4 R	5 R	6 R	Total
1986 %	-	na	na	-	na	-	800,701 100 %
1987 %	-	705,285 56.3 2	36,076 2.9 4	339,433 27.1 2	145,589 11.6 3	26,388 2.1 5	1,252,771 100 %
1988 %	23,819 1.4 6	414,674 24.2 3	52,887 30 2	1,039,218 60.7 1	145,989 8.5 4	36,068 2.1 5	1,712,655 100 %
1989 %	123,962 10.5 4	271,526 22.9 2	29,671 2.5 6	562,004 47.4 1	147,798 12.5 3	49,581 4.2 5	1,184,533 100 %
1990 %	146,609 14.4 4	349,168 34.4 1	43,354 4.3 6	272,579 26.9 2	147,989 14.6 3	54,435 5.4 5	1,014,134 100 %
1991 %	335,151 16.9 2	236,292 11.9 2	16,105 0.8 6	1,171,648 59.2 1	147,989 7.5 4	72,544 3.7 5	1,979,729 100 %

Notes:

1 = Income from term financing

2 = Income from Investment Accounts with *Bank Islam Malaysia Berhad*

3 = Dividend income from shares quoted in Malaysia

4 = Profit on disposal of shares quoted in Malaysia

5 = Rental income

6 = Other income

na =Not available

R = Ranking

Source : Compiled from *Annual Reports of Syarikat Takaful 1986 - 1991*.

During the first six years of operations, the largest proportion of income from the investment of the Shareholders' Fund was derived from the the income from its

Investment Account with *BIMB* in the second year, profit on disposal of shares quoted in Malaysia in the third and fourth years, income from Investment Account with *Bank Islam* in the fifth year and profit on disposal of shares quoted in Malaysia in the sixth year .

During the 1989 and 1990 financial years, *Syarikat Takaful* recorded an income of RM 1,184,533 and RM 1,014,134 respectively from the investments of its Shareholders' Fund, compared with RM 1,712, 655 in 1988. The decrease was attributable mainly to the reduction of income from the sales of quoted shares in Malaysia as a result of the scaling down on the disposal of such shares in view of the noticeable gains gradually emerging from the operations of both the Family and General *Takāful* Funds.⁸⁰ In other words, the sales of public quoted shares decreased from RM 1,039,218 in 1988 to RM 562,004 and RM 272,579 in 1989 and 1990 respectively. However, during the 1991 financial year, the profit from these sales increased again to RM 1,171,648 which resulted in an increase of the total income of the Shareholders' Fund's investment from RM 1,014,134 in 1990 to RM 1,979,729 in 1991, an increase of 95.2 per cent.⁸¹

(d) *Syarikat Takaful's Incomes*

As noted earlier and presented in Table 4.18 below, *Syarikat Takaful* derives its income from the share of profit derived from the Family *Takāful* Fund, the Group Family *Takāful* Fund and the General *Takāful* Fund as well as income from

⁸⁰ *Syarikat Takaful, Annual Report 1988*, p. 7; *Idem, Annual Report 1990*, p. 6.

⁸¹ *Syarikat Takaful, Annual Report 1991*, p. 6.

Shareholders' Fund's investments. *Syarikat Takaful*'s share of profit derived from the management of the General *Takāful* Fund increased from RM 0.1 million in 1986 to RM 4.3 Million in 1991, an increase of 4,200 per cent. Likewise, the share of profit attributable to *Syarikat Takaful* from the management of the Family *Takāful* Fund increased to RM 0.3 million in 1991 from RM 1,803 i.e. about RM 2 million in 1986, an increase of 14,900 per cent. Equally, a sum of RM 0.4 million as a profit credited to *Syarikat Takaful* from the management of its Group Family *Takāful* Fund in 1991 compared with RM 0.08 million in the first year of the Group Family *Takāful* plan's operation in 1989, an increase of 400 per cent over 1989.

Table 4.18

Syarikat Takaful's Incomes (RM Million)

Year	1	2	3	4	5	6	7
1986	0.8	0.1	0.2	-	0.9	1.5	-0.6
1987	1.3	0.6	0.02	-	1.9	1.9	0.000,4
1988	1.7	1.2	0.04	0.08	3.0	2.4	0.6
1989	1.2	2.9	0.08	0.08	4.2	2.7	1.5
1990	1.0	3.8	0.1	0.3	5.2	3.4	1.8
1991	2.0	4.3	0.3	0.4	7.0	4.3	2.7

Notes:

- 1 = Income from investment of Shareholders' Fund
- 2 = Profits from the General *Takāful* Fund
- 3 = Profits from the Family *Takāful* Fund
- 4 = Profits from the Group Family *Takāful* Fund
- 5 = Total income; 6 = Operating expenses
- 7 = Profits before *zakāt* and taxation (gross profits)

Source : *Syarikat Takaful Malaysia Sendirian Berhad, Annual Reports 1986 - 1991.*

The total income for *Syarikat Takaful* during the 1991 financial year increased to RM 7.0 million from RM 0.9 million in the 1986 financial year, an increase of about 678 per cent. After deducting the operational expenses, *Syarikat Takaful*

attained a profit of RM 2.7 million before *zakāt* and taxation in 1991, compared with RM 1.8 in the previous year. As presented in Table 4.19 below, *Syarikat Takaful* incurred a loss of RM 576,448 after payment of *zakāt* in the first year of its operation, while in the second year, it managed to break even, showing a small operating profit of RM 434, before the payment of *zakāt*. However, after the payment of *zakāt*, it still incurred a loss of RM 1,180. In the third financial year, *Syarikat Takaful* recorded a profit of RM 603,957 before the payment of *zakāt* and the provision of taxation. The net profit for the 1991 financial year stood at RM 1.6 million compared with RM 0.8 million previously, an increase of 98.1 per cent.

Table 4.19

Syarikat Takaful : Profit and Loss Accounts (in RM = Malaysian Ringgit)

Year	Gross Profits	<i>Zakāt</i>	Taxation	Net Profits	Annual Growth
1986	569,719	-	-	-576,448	-
1987	434	6,726	-	1,180	-
1988	603,957	1,614	253,000	347,357	29337.03%
1989	1,457,000	3,600	574,415	873,085	151.4
1990	1,757,588	13,347	926,200	818,041	-6.3
1991	2,707,996	20,559	1,066,517	1,620,920	98.1

Source : *Syarikat Takaful Malaysia Sendirian Berhad, Annual Reports 1986 - 1991.*

4.5. Some Issues Relating to the *Takaful* Schemes

(a) The *Takaful Act 1984*

The *Takaful Act* was intended to be only a regulatory piece of legislation and not a statutory source of the substantive law relating to an Islamic scheme of mutual insurance. It was recommended that the *takāful* operators should be regulated in the same way as commercial insurers. However, as the *takāful* business had to be operated along Islamic lines, it was felt that it was inappropriate to extend the Insurance Act 1963 to cover such operators. It was for this reason that the *Takaful*

Act 1984 was passed. The Act not only enables the Government of Malaysia to regulate and control *takāful* operators like all other insurers but also to ensure that the operation of the scheme does not depart from the teachings of Islam.

Notwithstanding, the application of the principles of Islamic law in the operation of the scheme is only implied in a few provisions of the *Takaful Act*. As such even the scope and application of those principles is unclear. According to the Act, a *takāful* business is defined as a business of *takāful* whose aims and operations do not involve elements opposed by the *Syariah*.⁸² Moreover, in relation to the registration of *takāful* businesses, the Act provides that the Director General of *Takaful* shall refuse to register an applicant unless he is satisfied, inter alia, that the aim and operation of the proposed *takāful* business will not involve any element which is "not approved" by *Syariah*.⁸³ The Act does not define *Shari'ah* nor does it explain what is meant by an element "approved" or "not approved" by *Shari'ah*. This is a serious omission as "approved by *Shari'ah*" may have a meaning far wider than "being permitted in Islam". This is because in Islam, apart from elements which are strictly prohibited (*harām*), there are also elements which are discouraged or frowned upon (*makrūh*) and those that are greatly encouraged (*sunnat*). While the presence of elements which are *harām* will clearly not be approved by the *Shari'ah*, it is not clear whether the presence of *makruh* elements will be approved or disapproved by the *Shari'ah*.

⁸² S. 2, *Takaful Act, 1984*.

⁸³ S. 8 (5) (a), *Takaful Act, 1984*.

(b) The *Syariah* Supervisory Council.

The *Takaful Act* makes it a condition for the registration of a *Takaful* Company that its articles of association has a provision for the establishment of a *Syariah* Supervisory Council whose function is to advise the company on matters pertaining to the *Syariah*.⁸⁴ The report of the Committee also recommended that members of the Council should be persons with expertise in areas like the *Syariah* and Islamic Economics.⁸⁵ It was also recommended that all decisions of the Council be made on the basis of the Islamic concept of *shurā* or consensus. The Council's function is strictly supervisory; it does not participate in the daily affairs of the company. Both the Act and the Report are silent on the status of the Council's advice. Perhaps a company that fails to act upon such advice can be regarded as pursuing aims contrary to the *Shari'ah*, thus allowing the Director General of *Takaful* to cancel the company's registration.

(c) The *Takāful* Contract

The *Takāful* contract is a contract based on the Islamic concept of *muḍārabah* between *Syarikat Takaful* as the entrepreneur (*muḍārib*) and the participant as the provider of capital (*ṣāhib al-māl*). In consideration for his participation in the scheme, the latter agrees to provide the former with the capital in the form of *takāful* contributions. The entrepreneur in return agrees to provide the participant with a scheme for investment and protection.

⁸⁴ S. 8 (5) (b), *Takaful Act, 1984*.

⁸⁵ Report of Committee, *op. cit.*, note 28, p. 30.

The *takāful* contract clearly spells out the rights and obligations of both parties, such as the way in which the contributions will be used and the ratio in which the profits, if any, will be shared. The Family *Takāful* contract also clearly spells out what proportions of the participant's contributions will be paid into the Participant Special Account (PSA) and the Participant Account (PA) respectively. It also declares that the proportion that is paid into the former is a donation made by the participant to help fellow participants. Thus everything there is to know about the contract is made known to the participant in the contract itself.

The *Takaful Act* provides that a person under eighteen shall not have the capacity to enter into a *takāful* contract.⁸⁶ This differs from the Insurance Act 1963, which provides that a person above ten years of age can enter into a contract of insurance provided that if he is below sixteen, he must have the written consent of his parents or guardian. Under the *Age of Majority Act 1971*,⁸⁷ a person attains the age of majority on his eighteenth birthday, but this is not the age of majority in Islam. In Islam, a person's legal capacity depends, among others, on whether he is *bāligh* (mature; legally major) and there is no definite age for this. Rather, it is determined by physical indications or by the declaration of the youth in question, or failing these, by reaching the age of fifteen years.⁸⁸

Admittedly, problems may arise if no specific age of majority is stipulated and the subjective test of *bulūgh* is used. The *takāful* scheme is not exclusively for

⁸⁶ S. 64, *Takaful Act, 1984*.

⁸⁷ S. 2.

⁸⁸ Schacht, *An Introduction to Islamic Law*, p. 124.

Muslims and such a test cannot be applied to others. Even amongst Muslims, the determination of *bulūgh* may give rise to problems. Hence, while the departure from the strict Islamic concept of majority is understandable, it is unclear why in this of all respects, the *Takaful Act* differs from the *Insurance Act 1963*.

In Islam as under the Common Law, a person continues to have the capacity to enter into a legal relationship for as long as he remains sane and fully responsible for his actions. Rightly therefore, the *Takaful Act* does not provide any maximum age for a participant to enter a *takāful* contract. In practice, however, the *Takāful* Company of Malaysia requires participants in the Family *Takāful* to be between the ages of eighteen and fifty years at the time they enter the contract. Thus, while someone who is over fifty legally has the capacity to enter into any contract, he cannot, in fact, enter a Family *Takāful* contract.

Conclusion

The above discussion clearly shows that *Syarikat Takaful* channels its funds, i.e. the Shareholders' Fund, the Family *Takāful* Fund, the Group Family *Takāful* Fund and the General *Takāful* Income, primarily in short-term investments such as investment with Investment Accounts with *Bank Islam Malaysia Berhad* and purchase of Malaysian Government Investment Certificates (MGIC) and purchase of shares and stocks quoted in Malaysia. As one of the Islamic financial institutions which offers and operates Islamic Insurance schemes based on *muḍārabah* and *takaful* contracts, *Syarikat Takaful* could play a more effective role in financing economic development in Malaysia by channelling its Funds and monetary sources in various ways of

investment, especially in project-financing using contracts of *muḍārabah* and *mushārah* or by financing the entrepreneurs to purchase of inputs and fixed assets using the contracts of *murābahah* and *bay' bi thamān ājil*. In the absence of an Islamic money-market, interest-free short-run financial instruments are not available, and the only channel open to *Syarikat Takaful* is to invest its Funds in *BIMB* but the returns are relatively low as the Bank itself is saddled with excess liquidity.

CHAPTER FIVE

PARTNERSHIP IN THE OPERATION OF *TABUNG HAJI*

CHAPTER FIVE : PARTNERSHIP IN THE OPERATION OF

TABUNG HAJI

Introduction

This chapter will critically examine the establishment and operations of *Lembaga Urusan Dan Tabung Haji (LUTH) (The Malaysian Pilgrims Management and Fund Board)*¹ as the mobilizer of the savings of Muslims in Malaysia and the investor of these savings in profitable investments in accordance with the principles of Islamic commercial law. The topics that will be discussed include the historical background and establishment of *Tabung Haji*, its corporate objectives, its economic activities and its role as an Islamic financial institution in Malaysia.

5.1. Historical Background and Establishment

Tabung Haji was established in August 1969 to mobilise the savings of Muslims and assist them in performing their pilgrimage to Mecca.² The historical evolution of *Tabung Haji* can thus be divided into two stages. The first stage was the setting up of the Malayan Muslims Pilgrims Savings Corporation in 1962. The initial idea behind the creation of this corporation was initiated by Royal Professor Ungku Abdul Aziz of the University of Malaya, a reputed academician and an authority on the rural economy, who after making an extensive study of the rural economy in the 1950s, presented a memorandum to the Government in 1959 entitled "**A Plan to Improve the Economic Position of Future Pilgrims**", suggesting the formation of the

¹ Hereafter referred to as *Tabung Haji*.

² *Tabung Haji, Annual Report 1990*, p. 9.

Pilgrims Savings Corporation which would assist Muslims to perform the *hajj* without impoverishing them or imposing financial hardships after the *hajj*.³

It was often assumed before 1962 that there were hardly any savings to be mobilized in the rural sector. The Muslims traditionally used to save their money in pillows, under mattresses, in cupboards or invested in land or livestock which would be later sold to meet the expenses of *hajj*.⁴ However, the ways by which this huge sum was saved⁵ were economically by functional activity which drained away funds that might otherwise be employed in commercial activity and would promote the economic development and national growth.⁶

Such saving behaviour among Muslims in Malaysia was not without justification. The main reason for resorting to saving outside the financial framework was to ensure that the money to be spent on the *hajj* was completely free from *ribā*. The savings facilities in any bank or financial institution at that time were unacceptable to these Muslims because of the presence of *ribā*.⁷

³ Muhammad Saleh bin Hj. Awang, *Haji di Malaysia : Sejarah dan Perkembangannya Sejak Tahun 1300 - 1405 Hijrah*, Terengganu, Malaysia, 1986, p. 255. *Tabung Haji, Annual Report 1990*, p. 8; *Tabung Haji, Tabung Haji as an Islamic Financial Institutions, The Operation and Mobilization of Investment Resources in an Islamic Way*, Kuala Lumpur, 1991, p. 3.

⁴ *Tabung Haji, Lembaga Urusan dan Tabung Haji Sebagai Institusi Pelaburan Islam*, Kuala Lumpur, 1990, pp. 7 - 8; Razali Nawawi, "The Administration of Islamic Financial Institution - Malaysia's Experience", in *Syariah Law Journal*, Vol. VII, (Petaling Jaya, September, 1991), p. 2.

⁵ Ungku Aziz in his study estimated that about RM 3 million was spent each year by pilgrims, a steady source of savings which the Government could not afford to neglect. See Ungku Abdul Aziz, *Pilgrims Economy Improvement Plan*, Kuala Lumpur, 1959, p. 1.

⁶ See Vonder Mehden, *Islam, Development and Politics in Malaysia*, Texas, U. S. A., 1978, p. 8; Focus, "Malaysia's *Tabung Haji*", in *al-Nahdah*, Vol. IX (1), 1989, pp. 5 - 6.

⁷ *Tabung Haji* (1991), p. 2; Razali Nawawi (1991), *op. cit.*, p. 2.

Therefore, Ungku Aziz recommended that future *hajjis* could save in the Corporation which would offer interest-free transactions and would yield profits. Profits derived from investments would be returned in the form of profit-sharing or dividends to depositors, thus not only avoiding *ribā* but also assisting them financially in meeting their expenses for *hajj*.⁸

Ungku Aziz's recommendation could not be implemented then as the Government was unable to resolve the question of *ribā*. Nevertheless, it was finally carried out in 1962, following the recommendation of Sheikh Mahmoud al-Shaltut, Rector of al-Azhar University, Cairo, who on his visit to Malaysia studied the plan and found it to be an absolutely *ribā*-free institution and technically sound. He praised the plan as one that would greatly benefit the Muslims in Malaysia and urged its implementation.⁹ Thus the Pilgrims Savings Corporation was incorporated in August 1962 and launched its operation in September 1962.¹⁰

The second stage in the development of *Tabung Haji* was marked by the merger between the Pilgrims Savings Corporation which operated in Kuala Lumpur and the Pilgrims Affairs Office which had been in operation since 1952 in Penang. The merger of these two institutions led to the establishment of *Lembaga urusan dan Tabung Haji* in August 1969.¹¹ *Tabung Haji* was officially incorporated in 1969

⁸ *Tabung Haji* (1991), p. 2.

⁹ *Tabung Haji, Annual Report 1990*, p. 8; *Tabung Haji* (1991), p. 3.

¹⁰ This Corporation was incorporated under the law (*Act of Parliament 34/62*). *Tabung Haji, Tabung Haji 25 Tahun*, Kuala Lumpur, n.d., p. 4.

¹¹ *Wang dan Urusan Bank di Malaysia*, 1992; *Idem, Bank Negara Malaysia, Annual Report 1990*, p. 154; *Tabung Haji, Annual Report 1990*, p. 8.

under the *Pilgrims Management and Fund Board Act 1969 (Act No. 8, 1969)* and in 1973 under the *Pilgrims Management and Fund Board Act (Amendment) 1973 (Act No. 168, 1973)*.¹²

5.2. Corporate Objectives

5.2.1. Aims and Objectives

The *Tabung Haji* board has been set up to accomplish the following goals:

1. to enable Muslims to save gradually so as to provide for their expenses in performing the pilgrimage or for other expenses that are beneficial to them
2. to enable Muslims, through their savings, to participate in investments in industry, commerce, plantations and real estates, as approved by the *Shari'ah*
3. to provide for the protection, control and welfare of Muslims while on pilgrimage through the various facilities and services of *Tabung Haji*.¹³

The clarity of the above goals enabled the formulation of the following objectives:

1. to render the best and most satisfactory services to Malaysian Pilgrims in matters pertaining to the performance of the *hajj*; and
2. to give maximum investment returns to depositors on their savings.¹⁴

¹² *Tabung Haji, Annual Report 1977*, p. 2; see also *Annual Report of Tabung Haji 1990*, p. 9.

¹³ *Tabung Haji, Annual Report 1990*, p. 9; Bank Negara Malaysia, *Wang dan Urusan Bank*, pp. 82 & 364; Cf. Abd Rahim, et al., "Economic Development and the *Hajj* : Preliminary Observations from Asia with Special Reference to Malaysia", in Kadir H. Din (ed.), *Development and the Muslims*, Bangi, 1993, pp. 193 - 208; Ozey Mehmet, "Malaysian Development by Trusteeship" in *Islamic Identity and Development*, Kuala Lumpur, 1990, pp. 159 - 160.

¹⁴ *Tabung Haji, Annual Report 1990*, p. 9.

In short, the objectives of *Tabung Haji* pertaining to public service and profits are quite specific and clear-cut, which give the organization a very good foundation for performance.

5.2.2. Organizational Structure

The organizational structure of *Tabung Haji* is shown in Figure 5.1 below. *Tabung Haji* is a semi-government body under the Prime Minister's Department. Its organizational structure reflects a fully autonomous body which is able to exercise its statutory powers and executive policies for the benefit of its depositors. Its highest authority, the board of directors is empowered under the Act of *Tabung Haji* to formulate policies and implement programmes in the interest of the organization and its depositors. Additional power is also given to administer the funds and all other matters pertaining to the welfare of the pilgrims.

Members of the board comprise a chairman, a deputy chairman, a representative of the Prime Minister's Department, a representative of the Treasury, a Director-General, not more than five other members appointed by the Prime Minister and a representative from the Ministry of Health (by invitation).¹⁵ Despite its vast powers, the board of directors would only act upon the advice of two advisory councils, namely the Financial Advisory Council on matters pertaining to finance and investments, and the *Hajj* Operation Advisory Council on matters regarding the

¹⁵ *Tabung Haji, Annual Report 1990*, p. 10; Section 3(3), *Act of Tabung Haji 1969*.

welfare of the pilgrims.¹⁶ Decisions made are then delegated to the management headed by the Director-General for implementation, and are supervised by two statutory committees, namely the Finance Committee and the Welfare Committee.¹⁷ Thus, the elements of check and balance are inherent in almost all processes and procedures to ensure efficiency and trustworthiness.

At the headquarters level, the management is divided into four departments each of which is headed by a Deputy Director-General, each specializing in specific activities:

1. The Department of Finance and Investment, which is responsible for all financial transactions in accordance with provisions stipulated in the Act of incorporation.¹⁸
2. The Department of *Hajj*, which is responsible for discharging all services pertaining to *hajj* affairs whether in Malaysia or Saudi Arabia.¹⁹
3. The Department of Administration and Information, which is responsible for matters pertaining to personnel recruitment, training and career development, and dissemination of information regarding *Tabung Haji* activities.²⁰
4. The Department of Corporate Affairs and Research, which is responsible for all corporate matters, such as promotion of corporate image and evaluation of corporate strategies, so as to ensure that *Tabung Haji* activities fulfil the

¹⁶ *Tabung Haji* (1990), *op cit.*, pp. 12 - 13.

¹⁷ *Ibid*, pp. 14 - 15; *Tabung Haji, 10 Tahun Tabung Haji 1963 - 1973*, Kuala Lumpur, p. 12; *Tabung Haji, Annual Report 1989*, pp. 16 - 17.

¹⁸ *Tabung Haji, Annual Report 1989*, p. 66; *Idem, Annual Report 1990*, p. 81.

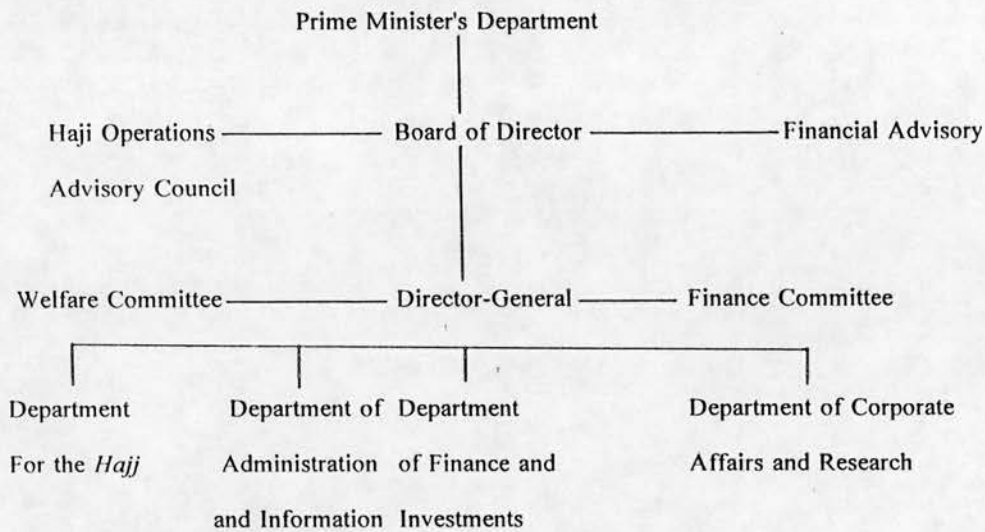
¹⁹ *Tabung Haji, Annual Report 1989*, p. 15.

²⁰ *Tabung Haji, Annual Report 1990*, pp. 54 & 59.

needs of depositors and investors.²¹

Each of the above departments is divided into divisions which are further subdivided into branches, units and sections to provide a better supervision and control.

Figure 5.1 : *Tabung Haji* : Organizational Structure



Source : *Lembaga Urusan dan Tabung Haji*.

5.3. Economic Activities of *Tabung Haji*

5.3.1. Mobilization of Deposits

Tabung Haji currently provides only one form of saving facility, that is , deposit facility. It accepts deposits from its members on the *Shari'ah* principle of *wadi'ah*.

²¹ *Tabung Haji, Annual Reports* 1987, p. 56; 1989, p. 93 and 1990, p. 81.

This facility is open to all Malaysian Muslims, with the minimum deposit required to open an account being RM 2.00.²² In the contract of *wadī'ah*, the depositors grant permission to *Tabung Haji* to use their deposits for investment purposes. Any profits from the investment are then distributed among depositors in the form of bonus after the payment of *zakāt* and after allocations have been made. No savings account book is issued on opening an account. Instead, each member is given an account number which is used when subsequent deposits are made. A statement of account is sent to depositors twice yearly, that is, on 30 June and 31 December. Bonuses are calculated at the end of the year and credited to the account of individual depositors after the net distributable profit for the year minus *zakāt* has been determined.²³

Depositors can make their savings at the *Tabung Haji* head office in Kuala Lumpur or any branch offices in any state and province or through any post office throughout the country or by monthly salary deductions. These methods of savings have been devised on the premise that they are fool-proof, convenient for all members, and can easily administered with the least possible expenditure.²⁴

Besides, to attract new depositors, *Tabung Haji* through its Information and Relations Division has launched from time to time various savings schemes for schools, government departments and the private sectors. These include:

1. Saving schemes for school-children by introducing coin-boxes which are sold

²² *Tabung Haji, Risalah Simpanan*, n.d.

²³ *Tabung Haji, Annual Report 1984*, p. 37.

²⁴ *Tabung Haji, Annual Report 1989*, p. 39.

at RM 5.00 each.²⁵

2. Saving schemes for dependants where a depositor is encouraged to extend his monthly salary deduction to his dependants.²⁶
3. A monthly Bonus Payment Scheme for accounts exceeding RM 10,000 for at least a year. Bonuses credited at the end of each year will be paid in equal monthly instalments the following year. This scheme is specially devised for depositors in the lower income group who receive compensation from the government for their land and property forgone for development purposes. Through this scheme, they are ensured a fixed monthly income.²⁷

5.3.2. Withdrawal of Deposits

Tabung Haji is one of the very few financial institutions that provide a direct link between savings and purpose. As such, savings deposited with *Tabung Haji* cannot be withdrawn for reasons other than to defray all or part of the depositor's pilgrimage expenses, except in the following cases:

1. the death of the depositors
2. when age, health and so forth, make it difficult for the depositor to undertake pilgrimage
3. on production of satisfactory evidence that the depositor intends to emigrate

²⁵ *Tabung Haji, Annual Report 1990*, p. 67.

²⁶ *Tabung Haji, Bagaimana Anda Boleh Menjadi Penyimpan di Tabung Haji*, Kuala Lumpur, n. d., pp. 2 - 4.

²⁷ *Tabung Haji, Annual Report 1986*, pp. 26 - 30.

from Malaysia.²⁸

On principle, withdrawals are allowed only once in six months, with a maximum withdrawal of up to 80 per cent of the individual's credit balance. However, 100 per cent withdrawals are allowed for the exceptional reasons stated above. A member who is registered for pilgrimage in a certain year cannot make withdrawals within six months before his departure but is allowed to withdraw his savings in Mecca or Medina. It may be noted that the rules governing withdrawals of deposits accord a long-term character to deposits so as to ensure that the primary aim of enabling the members to save for the pilgrimage is achieved. Moreover, funds of the *Tabung Haji* could be invested in long-term investments which usually take at least six months for profits to accrue.

5.4. *Tabung Haji* as a Financial Institution : An Evaluation of Performance

5.4.1. Branch Network and Employment Structure

In the early years of its incorporation, *Tabung Haji* started off with very few branch offices and a staff of hardly twenty. However, as at the end of 1991, its branch offices had increased to 86,²⁹ with 15 divisions under 4 departments at the headquarters level in Kuala Lumpur. At the same time, the total number of staff

²⁸ Interview with Che Gayah Salleh, Investment Officer of *Tabung Haji*, Kuala Lumpur, 25/11/94 ; *Tabung Haji, Deposit and Withdrawal Division*; Radiah Abdul Kader, "The Malaysian Pilgrims Management and Fund Board and Resource Mobilizations" in Mohamed Ariff (ed.), *The Islamic Voluntary Sector in Southeast Asia*, Singapore, 1991, p. 143.

²⁹ This includes 83 branch offices in Malaysia and 3 branch offices in Saudi Arabia. *Tabung Haji, Annual Report 1990*, p. 53.

stood at 1021 with a high proportion of semi-skilled workers, including clerks and technicians. The proportion of professional and semi-professional staff is still small, comprising less than 20 per cent of total employees as presented in Table 1 below.

Table 1

Tabung Haji : Total number of staff; professional, semi-professional and semi-skilled workers, 1989 - 1990.

Group	1989	1990
A (Professional)	63	65
B (Semi-Professional)	99	99
C (Semi-skilled workers)	460	557
D (Semi-skilled workers)	278	274
Other staff:		
Local staff in Saudi Arabia	13	14
Contract Staffs	19	12
Total	932	1021

Source: *Tabung Haji, Annual Report 1990*, p. 54.

5.4.2. Growths of Deposits

Table 2

Tabung Haji : Total Deposits and Total depositors, 1986 - 1990.

Deposits			Total depositors	
Year	Total Deposit (RM)	% Increase	Persons	% Increase
1986	480,099,744	00	976,438	00
1987	600,131,082	20	1,116,141	12.5
1988	789,538,420	24	1,301,937	14.3
1989	1,014,444,385	22.2	1,512,088	13.9
1990	1,074,494,357	5.6	1,735,678	12.9

Source : *Bank Negara Malaysia, Annual Reports 1986 - 1990; Tabung Haji, Annual Reports 1987 - 1990.*

As at 31 December 1990, *Tabung Haji* had accumulated a total of RM 1,074,494,357 worth of deposits with the total number of depositors reaching 1,753,678 persons as presented in Table 2 above.

Table 3

Tabung Haji : Growth of deposits and the Number of New Depositors, 1969 - 1990.

Year	Deposits received		New depositors	
	RM million	% increase	(000)	% increase
1969	7.0		7.1	
1970	9.4	34.3	12.4	74.6
1971	10.7	13.8	12.9	4.0
1972	18.4	72.0	23.9	85.3
1973	29.4	59.8	42.0	75.7
1974	51.7	75.9	82.6	96.7
1975	42.7	-17.4	35.8	-96.7
1976	22.8	-46.6	15.5	-56.7
1977	26.9	18.0	27.1	74.8
1978	47.8	77.7	30.6	12.9
1979	68.8	43.9	34.7	13.4
1980	108.4	57.6	51.6	48.7
1981	150.3	38.7	58.4	13.2
1982	182.7	21.6	66.4	13.7
1983	195.9	7.2	75.1	13.1
1984	209.5	6.9	133.4	77.6
1985	226.7	8.2	123.8	-7.2
1986	275.2	21.5	127.7	3.2
1987	331.5	20.5	138.6	8.5
1988	446.9	34.8	185.9	34.1
1989	556.9	24.6	212.8	14.5
1990	557.3	0.07	241.6	13.5

Source : Compiled from *Annual Reports of Tabung Haji 1976 - 1990*; *Idem*, *Deposit and Withdrawal Division*.

Table 3, above, provides data relating to annual deposits received, new depositors and their growth for the period 1969 to 1990. With the exception of 1975 and 1976, the growth of deposits during the past two decades shows an increasing trend. Savings were in the range of RM 7 - 70 million a year during the 1970s and RM 100 - 560 million a year in the 1980s and in 1990. The most remarkable growth occurred

between the third and fifth year of *Tabung Haji*'s existence with deposits growing at an average rate of 69 per cent. This may be attributed mainly to the success of publicity measures undertaken in the rural areas beginning in 1972. Grand-scale campaigns were launched in four major states where the majority of the rural Malay population was concentrated. In 1974, small-scale campaigns were extended to mosques and schools and exhibitions were held in various Government agencies. The success of the publicity drive was followed by the opening of new branch offices in twelve states peninsular Malaysia.³⁰

A sharp decline in the volume of deposits in the years 1975 and 1976 (falling at an average of 30 per cent per year) was caused by the implementation of the Shaykh System in Mecca and Medina in 1975. In this system, pilgrims were not allowed to choose a particular shaykh as their guide. This new ruling proved unpopular among pilgrims because it often meant separation from friends and relatives during the pilgrimage.³¹ Another major factor was the worldwide inflationary situation which caused a rise in pilgrimage expenses. Total expenses to perform pilgrimage increased to RM 2,720 - RM 3, 270 per person in 1976 from RM 1,500 in 1975, an increase of 100 per cent.³² These two factors led to a decrease in the number of pilgrims, which in turn affected the volume of deposits.

Deposits started to rise again in 1977, following the annulment of the Shaykh System and have continued to increase ever since. However, since the beginning of

³⁰ Radiah Abdul Kader (1991), *op cit.*, p. 145.

³¹ *Tabung Haji, Annual Report 1976*, p. 5.

³² *Ibid*, p. 6.

1981, the rate of increase has slowed down, which may be due to the economic recession. Trends in the growth of depositors more or less follow the trend in deposit growth, with peaks in 1972 - 1974 and troughs in 1975 - 1976. Growth between 1978 and 1983 (excluding 1980) was rather moderate, with average increases of 13 per cent. The huge increase in the number of depositors in 1984 consisted mainly of school-children³³ and new deposits recruited through the salary deduction scheme.³⁴

Table 4

Tabung Haji : Deposit Accumulation, 1988 - 1990

Method of Saving	1988		1989		1990	
	RM Mil.	%	RM Mil.	%	RM Mil.	%
1. Salary Deduction	142.7	30.6	181.2	32.5	221.8	39.8
2. Counter Collection and Campaign	298.1	63.8	347.1	62.3	310.2	55.6
3. Post Office	24.8	5.3	25.9	4.7	21.7	3.9
4. Student and Children Box Savings	1.3	0.3	2.7	0.5	3.6	0.7
Total	466.9	100	556.9	100	557.3	100

Source : Compiled from *Annual Reports of Tabung Haji 1988 - 1990*.

An examination of *Tabung Haji* deposits can also be viewed from various categories of depositors, which can be classified mainly as : (1) those who intend to perform pilgrimage; (2) employees in the Government and private sectors; (3)

³³ *Tabung Haji, Annual Report 1984*, p. 38.

³⁴ *Ibid.*

ordinary depositors; (4) students and children.³⁵

Table 4 above shows data on the annual deposits accumulated by *Tabung Haji* using various methods of collection from 1988 to 1990. Data from Table 4 shows that the method of saving by counter collection and campaign represents the largest per cent of total annual savings. It was followed by savings using the method of salary deductions, post offices and students and children's savings.

5.4.3. Investment Activities

Even though initially *Tabung Haji* was established solely to facilitate Malaysian Muslims performing pilgrimage,³⁶ it is not prohibited from engaging in investment activities.³⁷ The provision made under the Act has been translated into the aims and objectives of *Tabung Haji* at the operational level, namely: (i).the collection and management of the pilgrimage fund; and (ii).the administration and management of pilgrims.

Thus, the Act permits *Tabung Haji* to invest the depositors' money in order to generate profits which will then distributed among the depositors in the form of bonuses. In implementing its function, *Tabung Haji* adheres to the *Shari'ah* principle

³⁵ *Tabung Haji, Annual Report 1990*, pp. 6 - 7.

³⁶ The Preamble of *Tabung Haji Act*, 1969 (Act No. 8, 1969) specifies that the main function of *Tabung Haji* is to manage a fund for the maintenance and utilization of savings in connection with the protection, control and general well-being of the pilgrimage to Mecca and matters ancillary thereto.

³⁷ Section 4, *Tabung Haji Act* 1969 provide : It shall be the function of the *Lembaga (Tabung Haji)* to administer the fund and all matters concerning the welfare of the pilgrims and to formulate policies in connection therewith and do so such other things as may be done under this Act.

of *wadī'at al wakālah al-muḥlaqah*, i.e. the depositors give consent to *Tabung Haji* to manage their deposits for the purpose of investment.

Since the funds deposited with *Tabung Haji* by Malaysian Muslims are being held for purpose of the pilgrimage, the areas of investments have to be within the framework of the *Shari'ah*.³⁸ Therefore, *Tabung Haji* does not invest its funds in government interest-bearing securities, other interest-bearing securities or shares in companies producing goods which are forbidden in Islam. Nevertheless, the scope of investment is still broad. At present, there are four types of investments undertaken by *Tabung Haji* as follows:

1. investment in shares (equity participation)
2. investment in subsidiary companies
3. investment in land and building³⁹
4. short-term investment.⁴⁰

The investment activities of *Tabung Haji* can be classified into two types of investments, that is long-term and short-term investments. Investments in the *BIMB* are in the form of short-term investments; while investments in shares (equity participation), subsidiary companies and land and building are classified as long-term investments. All these investment activities are currently carried out under the principles of *muḍārabah* (profit-sharing), *mushārah* (equity participation) and

³⁸ Section 23(1), *Tabung Haji Act*, 1969 provides for the assets of the funds to be invested in such manner as the *Tabung Haji* management thinks fit.

³⁹ All these types of investments are in a long-term investments.

⁴⁰ *Tabung Haji* (1991), p. 13.

ijārah (leasing).⁴¹

To ensure that investments made by *Tabung Haji* are in compliance with the *Shari'ah* rules, each decision made in matters pertaining to investment is brought under the advice of the National Advisory Council, for instance, if *Tabung Haji* is doubtful as to whether such business conducted by the companies is in accordance with the *Shari'ah*. At present, this advice is sought from the expertise of the Religious Supervisory Council of *BIMB*.⁴² Therefore, divergence from the *Shari'ah* principles should result in the withdrawal of shares or participation by *Tabung Haji*. These have been occasions in the past when such actions were deemed necessary and were taken by *Tabung Haji*.⁴³

1. Investment in shares

Investment in shares is limited to selected Malaysian equities as permitted by the *Shari'ah*. These include shares of companies in major sectors such as plantations, agriculture, manufacturing, trade, transport, mining and properties. The amount of equity participation depends on the amount being offered but generally *Tabung Haji* does not participate as a major shareholder. In cases where *Tabung Haji* or its subsidiary companies are a substantial shareholder, that is, holding between 20 to 50

⁴¹ *Tabung Haji, Lembaga Urusan dan Tabung Haji*, n. d., p. 6.

⁴² Interview with Che Gayah Salleh, Investment Officer of *Tabung Haji*, Kuala Lumpur, 25/11/94; See also W. M. Wan Hussein, "Pengurusan Kewangan dan Pelaburan Islam : Pengalaman *Tabung Haji*", p. 32. Paper presented at the *Seminar Pentadbiran dan Pengurusan Islam*, ITM, Selangor, Malaysia, 1991.

⁴³ For example, in 1970s, *Tabung Haji* withdrew its investment from businesses involving liquor and the hotel business. This attitude continued into the 1980s when two companies namely Rasa Sayang Hotel and Bousted Holdings Limited were withdrawn from the *Tabung Haji* investment portfolio since they had later diversified into activities not according to *Shari'ah*. *Berita Harian*, 7 January, 1986, p. 1.

per cent of the equity of a company, *Tabung Haji* officials are represented on the company's board of directors.⁴⁴ Constant reviews are made by *Tabung Haji* officials on the activities of the companies to ensure that they comply with the *Shari'ah* rules. If found otherwise, *Tabung Haji* will sell off its shares in the company.⁴⁵ Shares of the companies are acquired in the form of quoted shares which are directly bought in the Kuala Lumpur Stock Exchange, or unquoted shares which are acquired when issued to the public. Equity shares are also acquired through partnership or joint-ventures with other companies.⁴⁶

Table 5

Tabung Haji : Annual Investment in Shares, 1987 - 1990.

Types of Shares	1987 RM Mil.	1988 RM Mil.	1989 RM Mil.	1990 RM Mil.
1. Quoted Shares	16.6	3.62	44.18	94.90
2. Unquoted Shares	14.15	30.13	9.96	89.10
3. Subsidiary Companies' Shares	3.0	8.50	15.99	10.95
4. Funds Managers' Shares	5.66	2.46	-	-
5. Other Shares	2.27	5.48	4.74	3.72
Total	41.14	50.19	73.87	198.69

Source : Compiled from *Annual Reports of Tabung Haji 1987 - 1990*.

As at 31 December 1990, *Tabung Haji* had invested its funds of RM 198. 69 million in the acquisition of shares. As presented in Table 5 above, a large portion of its annual investment in shares was in the acquisition of shares of companies in

⁴⁴ *Tabung Haji, Annual Report 1990*, pp. 93 - 97.

⁴⁵ Interview with Che Gayah Salleh, Investment Officer of *Tabung Haji*, Kuala Lumpur, 25/11/94.

⁴⁶ *Tabung Haji, Annual Report 1990*, p. 34.

the form of quoted shares and unquoted shares, followed by the acquisition of shares in its subsidiary companies, funds' managers shares and other shares in the market.

Table 6

Tabung Haji : (Total) Accumulation of investment in shares according to economic sectors, 1987 - 1990

Sectors	1987 RM Mil. %	1988 RM Mil. %	1989 RM Mil. %	1990 RM Mil. %
1	205.6 59.0	232.6 59.5	227.4 55.81	370.88 62
2	69.1 19.8	76.2 19.4	103.4 25.38	110 18
3	36 10.3	42.3 10.8	35.4 8.7	76 13
4	21.8 6.2	21 5.4	19.5 4.8	19.2 3
5	14 4.8	16.2 4.0	18.3 4.5	15.9 3
6	2.6 0.7	3 0.8	3.4 0.8	3.5 1
Total	100	100	100	100

Notes: 1 = Manufacturing, processing and trading; 2 = Plantation industry; 3 = Real estate; 4 = Rubber industry; 5 = Mining industry; 6 = Others

Source : Compiled from *Annual Reports of Tabung Haji 1987 - 1990*.

During the financial years 1987 to 1990, a substantial portion of *Tabung Haji's* investment in stocks and shares, that is about 55 to 60 per cent as shown in Table 6 above, went into the acquisition of shares in manufacturing, processing and trading industries, as against the 18 to 25 per cent and 8 to 13 per cent from the total accumulation of investment in shares invested in the plantation industry and real estate sector respectively. The rest of its investment in shares went into other economic sectors such as rubber and the mining industries as shown in Table 6 above.

2. Investment in subsidiary companies

Investment in subsidiary companies is undertaken to enable *Tabung Haji* to participate actively in economic activities. Subsidiary companies are companies which have been incorporated and are wholly owned by *Tabung Haji*. Currently, *Tabung Haji* has formed 6 (six) subsidiary companies; three of which operate in the plantation industry and the rest of which are involved in real estate, transport and trading, and property management.⁴⁷

1. The Plantation Corporation Limited
2. Sabah Plantation Corporation Limited
3. The Construction and Housing Company Limited
4. The Transport and Trading Corporation Limited
5. Urus Bina Limited
6. *Tabung Haji* Plantation (Holdings) Limited.⁴⁸

The Plantation Corporation Limited was formed in August 28, 1972 with an authorized and paid-up capital of RM 50 million. The corporation is actively involved in agricultural activities such as oil-palm, cocoa and rubber plantations and its plantations are situated in parts of Pahang and Johor, covering areas of 12,586 hectares.⁴⁹

⁴⁷ *Ibid*, pp. 88 - 91.

⁴⁸ *Tabung Haji, Annual Report 1990*, pp. 88 - 91; Razali Nawawi (1991), *op. cit.*, pp. 6 - 7.

⁴⁹ *Tabung Haji, Annual Report 1990*, pp. 88 - 89; *Idem, Perbadanan Ladang-ladang Tabung Haji Sdn. Bhd.*, n. d.

Sabah Plantation Corporation Limited was established with an authorized capital of RM 50 million and paid-up capital of RM 34,975,504. The main activity of this corporation is oil-palm plantations which are situated in Sungai Tenegang and Sungai Koyah, Sabah, covering an area of 3,963.6 hectares.⁵⁰

The Construction and Housing Company Limited was incorporated in 31 October 1980 with a paid-up capital of RM 16 million and amounted to RM 20 million at the end of 1990. The main operation of this company is building houses and commercial buildings for sale to *Tabung Haji* members and the public.⁵¹

The Transport and Trading Corporation Limited was formed in September 9, 1972 with an authorized capital of RM 2 million. The main activity of this company is to arrange charter flights with the national airline carrier to transport pilgrims to Mecca and other matters pertaining to the pilgrimage.⁵²

Urus Bina Limited's main function is to supervise the management of buildings belonging to *Tabung Haji* all over the country including the provision of security services to the buildings.⁵³ *Tabung Haji* Plantation (Holdings) Limited was incorporated in 20 December 1988 with an authorized capital of RM 25 million and a paid-up capital of RM 3,435,175. The main activity of this company is to develop land for plantations on partnership basis with the owner of the land. For example, this

⁵⁰ *Ibid.*, pp. 89 - 90; *Tabung Haji, Tabung Haji 25 Tahun*, n. d., p. 29.

⁵¹ *Ibid.*, p. 28; *Tabung Haji, Annual Report 1989*, p. 108; *Annual Report 1990*, p. 90.

⁵² *Ibid.*, p. 90; See also *Idem, Perbadanan Pengangkutan dan Perusahaan Tabung Haji Sdn. Bhd.*, n. d.

⁵³ *Ibid.*

company has been involved in a partnership contract with *Majlis Agama Islam Negeri Sembilan* (MAINS) (Religious Council of Negeri Sembilan) to plant oil-palm on land covering areas of 951 hectares in Gemas, Negeri Sembilan.⁵⁴

3. Investment in real estate

Activities under this heading involve the construction of buildings for the use of *Tabung Haji* offices as well as for rental purposes.⁵⁵ Besides construction of buildings, *Tabung Haji* also buys buildings for leasing and buys potential lots of land for future development to form a land bank.⁵⁶

Tabung Haji's investment in land and building as at 31 December 1990 amounted to RM 16.67 from RM 13.6 million in 1989, an increase of RM 3.07 million or 22.6 per cent.⁵⁷ Total Investment in land and building as at the end of 1990 amounted to RM 206.6 million.⁵⁸ It is the aim of *Tabung Haji* to have its own building in every major town in Malaysia either for its own use or for rental purposes. *Tabung Haji's* biggest investment in this field is the construction of its thirty-eight storey headquarters building on Jalan Tun Razak, Kuala Lumpur, which was completed in 1985 at a total cost of RM 109 million (including the cost of

⁵⁴ *Ibid.*, p. 90.

⁵⁵ Buildings owned by *Tabung Haji* locate not only in Malaysia but also in Saudi Arabia. *Ibid.*, p. 27.

⁵⁶ *Ibid.*

⁵⁷ *Tabung Haji, Annual Report 1990*, p. 6.

⁵⁸ *Ibid.*, p. 20.

land).⁵⁹ As at the end of 1988, *Tabung Haji* was regarded as one of the institutions which owned the largest amount of property in Malaysia with 62 buildings all over the country and a very sizeable land bank.⁶⁰

4. Short-term investment

Table 7

Tabung Haji : Short-term investment, 1988 - 1990

	1988 RM Mil.	1989 RM Mil.	1990 RM Mil.
1. <i>BIMB</i> , Jeddah	-	3.3	-
2. Islamic Development Bank, Jeddah	-	2.7	2.8
3. <i>BIMB</i> , Kuala Lumpur	206	36.3	-
4. Government Investment Securities	50.9	368.4	234.7
5. Gulf International Bank Bahrain (GIB)	14.3	68.7	0.008
6. <i>BIMB</i> , London	-	-	33.7
7. <i>Bay' bithaman ājil</i>	-	-	40
8. <i>Musyārakah</i>	-	-	50
Total	271.2	479.4	361.208

Source : Compiled from *Financial Statements of Tabung Haji 1988 - 1990*.

Short-term investment means investment undertaken by *Tabung Haji* and its subsidiary companies through a special investment account with *BIMB* and Government Investment Certificates using the contract of *muḍārabah*. In the case of *BIMB*, the ratio of profit-sharing is 75:25 in *Tabung Haji*'s favour. Moreover, a normal short-term surplus is maintained in the current account and invested by the bank, and profits are shared in a ratio of 70:30. *Tabung Haji* also invests its

⁵⁹ *Tabung Haji, Annual Report 1988*, p. 43.

⁶⁰ *Tabung Haji, Annual Report 1989*, p. 27.

temporary short-term funds in the Islamic Development Bank in Jeddah, Saudi Arabia, Islamic Bank (Malaysia) Limited in London, and London and Gulf International Bank of Bahrain in accordance with the Islamic principle of *mudārabah*. Moreover, in 1990 *Tabung Haji* also invested its funds of RM 50 million in project financing with Shell Company MDS (Malaysia) Limited under the principle of *mushārah*, and financing the acquisition of assets for Sarawak Shell Company Limited under the principle of *bay' bi thaman ājil* amounting to RM 40 million as shown in Table 7 above.

5.4.4. Income From Investments

Income received by *Tabung Haji* is derived from its investments. As presented in Table 8 below, *Tabung Haji* receives four types of major income, namely:

1. Dividends from investment in shares;
2. Rent from buildings;
3. Profit from short-term investment in *BIMB*; and
4. Profit from the sale of shares.

Table 8

Tabung Haji : Composition of Income from Investments, 1987 - 1990.

Type of Income	1987 RM Mil. %	1988 RM Mil. %	1989 RM Mil. %	1990 RM Mil. %
1.	29.53 29	39.04 52.7	45.81 40	40.87 40
2	11.61 11.5	11.20 15.1	11.22 10	13.00 13
3	3.52 3.5	6.38 8.6	14.87 13	25.01 25
4	43.71 43	5.81 7.8	26.92 23	10.10 10
5	2.8 3	2.68 3.6	7.97 7	5.33 5
6	10.0 10	9.00 12.1	8.00 7	7.00 7
Total	101.22 100	74.11 100	114.80 100	101.31 100

Notes :

1 = Dividend from shares; 2 = Rental income;

3 = Profit from short-term investment; 4 = Profit on sale of shares

5 = Other incomes; 6 = Government grant

Source : *Tabung Haji, Annual Reports 1987 - 1990.*

As shown in Table 8 above, the income of *Tabung Haji* has been stable over the four year period 1987 - 1990. With the exception of 1988, total annual income received by *Tabung Haji* over this period was around RM 100 million. During the financial years 1988 to 1990, dividends from investment in shares made the largest contribution to annual income. However, in 1987 more than 40 per cent of income came from the profit on the sale of shares, while income from dividends constituted 29 per cent of the total annual income.

Until 1988, rent from buildings constituted the third major source of income. However, from 1989, the third major source of income has been the profit from short-term investment in *BIMB*. Profit from this short-term investment seems to have increased during the financial years 1987 to 1990. The grant (subsidy) from the Malaysian Government seems to be declining, i. e. from RM 10 millions to RM 7 millions over the four years. This grant is specially allocated so as to cover the expenses of pilgrims before or after departure to Mecca.

5.4.5. Appropriation of Profits

Table 9 below shows that the pre-*zakāt* profits made during the financial years of 1981 to 1986 have been stable with a slight fall in 1985 and 1986, i.e. RM 25.9 million and RM 23.4 million respectively, owing to the economic recession. However, during the financial years 1987 to 1990 the pre-*zakāt* profits made have been inconsistent. The main factor which contributed to the fluctuation of the *Tabung Haji*'s profits during those financial years was the profits on the sale of shares. For example, in 1987 RM 43.71 million out of RM 64.45 million of the pre-*zakāt* profits of *Tabung Haji* was generated from the sale of shares, an increase of RM 41.52 million from the previous year, which was RM 2.19 million.

Table 9

Tabung Haji : Distribution of Tabung Haji Profits, 1981 - 1990.

Year	Profits (before <i>zakāt</i>) (RM Million)	<i>Zakāt</i> (RM Million)	Bonus	
			----- RM Million	%
1981	32.4	1.6	10.3	9.0
1982	32.2	2.3	12.7	8.0
1983	29.4	2.8	15.2	8.5
1984	29.8	1.4	34.5	8.5
1985	25.9	1.2	27.1	9
1986	23.4	1.4	27.7	7
1987	64.5	2.3	36.4	7.5
1988	38.5	2.1	39.3	6.5
1989	73.8	2.4	55.7	7.0
1990	56.2	3.0	25.5	6.5

Source : Compiled from *Annual Reports of Tabung Haji 1981 - 1990*.

5.4.6. Payment of *Zakāt*

Tabung Haji has been paying *zakāt* on wealth and commerce since 1980. The rate of *zakāt* is 2.5 per cent on the sum of profits earned and the amount of working capital at the end of the financial year.⁶¹ *Zakāt* payments are made to the Islamic Religious Department in each state which in turn redistributes the *zakāt* fund among the various beneficiaries. The amount received by each state is based on the credit balance of the depositors in the respective states.⁶² At the end of the financial year 1990, *zakāt* payment made by *Tabung Haji* was RM 3 million which in turn could be used to help, for example, poor and needy Muslims in Malaysia as well as to carry out economic projects aimed at improving the socio-economic conditions of Muslims in Malaysia. In other words, *Tabung Haji* has also made a contribution to the economic development of Malaysia by increasing payment of *zakāt* each year as presented in Table 9 above.

5.4.7. Payment of Bonus⁶³

A large proportion of *Tabung Haji* net profits are distributed to depositors in the form of bonuses. The annual rate of bonus varies from 6.5 to 9.0 per cent during 1981 - 1990 financial years, as presented in Table 9, depending on profit made. However, at times when profits were very low, part of the *Tabung Haji* general

⁶¹ The question of *zakāt* was raised some years ago but a clear *fatwā* (decree) was issued to the management of *Tabung Haji* only in 1979. *Tabung Haji, Annual Report 1981*, p. 19; *Annual Report 1984*, p. 37.

⁶² *Tabung Haji, Zakāt*, n. d.

⁶³ *Tabung Haji, Bonus*, n. d.

reserves were used to pay a reasonably high bonus. This practice was evident in 1984 and 1985 when the bonus payment amounted to 115 and 104 per cent of the total profits respectively. As a result, *Tabung Haji* was able to offer a competitive rate of return to depositors at 8.5 and 9.0 per cent, which was comparable to the return from other types of Islamic financial institutions' investments in the country such as *BIMB*. As a matter of fact, these rates of bonuses were relatively higher than the 5 per cent rate of profit paid on savings accounts in *BIMB* as at December 1985.

5.4.8. Evaluation of Performance and Recommendations

Tabung Haji is a financial institution of a special kind. It mobilizes funds from savers (depositors) and channels them to investors. It acts as a banker and service organization to its members and when they decide to perform the pilgrimage, it caters for their needs before departure such as handling visa requirements, arrangements, arranging for transportation, and giving information and education on pilgrimage. Services catered for by *Tabung Haji* in Mecca include the provision of accomodation, food and medical and health care. The economic activities of *Tabung Haji* emanate from its role as a banker to its members whereby it attempts to convert their deposits into profitable investments.

Tabung Haji's performance can be evaluated from two aspects: (1) its success in achieving its aims and objectives and (2) its contribution to the development process. Looking at the growth of the size of its deposits and the number of its depositors since its incorporation, it is apparent that *Tabung Haji* has been successful in achieving its aim of enabling Muslims to save for the purpose of performing the pilgrimage. When it was first formed in 1963, the organization had only 7.1 thousand

members (depositors) with a total savings of RM 7 millions. However, as at the end of 1990, its depositors reached 1,753,678 persons with total savings amounting to RM 1,074.5 million.⁶⁴

The contribution of *Tabung Haji* in the process of economic development lies in its role as the user of investible funds deposited with it.⁶⁵ Its average annual inflow of RM 40 millions⁶⁶ illustrates the significant role it plays, as an investment organization, in the economic development of the country. Thus far, *Tabung Haji* has been successful in channelling its resources to specified areas and giving high returns to depositors on their savings. The annual rate of bonus given to its depositors is between 6.5 to 9.00 per cent which is regarded as a competitive rate in comparison with other financial institutions in Malaysia.

Besides giving direct benefits to its depositors, *Tabung Haji* has also brought various benefits to the Malaysian Muslims at large. Direct investments undertaken by its subsidiary companies in the agricultural and real estate sectors provide employment to more Muslims, in addition to increasing Muslim property ownership in the country. In other words, *Tabung Haji*, like other trust agencies, acts as an instrument in hastening the process of reducing the Malay 'capital deficiency gap' in the above-mentioned sectors, while at the same time avoiding unequal distribution of ownership amongst the Muslims, for the bulk of *Tabung Haji's* investments take the form of share equities in companies engaged in manufacturing, the leading growth

⁶⁴ *Tabung Haji, Annual Report 1990*, p. 67; *Bank Negara Malaysia, Annual Report 1990*, p. 154.

⁶⁵ See Lee Hock Lock, *Household Savings in West Malaysia and the Problem of Financing Economic Development*, Kuala Lumpur, 1971, p. 197.

⁶⁶ Radiah Abdul Kader (1991), *op. cit.*, p. 159.

sector in the Malaysian economy. As the minimum amount of subscription to share issues is generally beyond the means of most Muslim savers at any one time, *Tabung Haji* plays the supporting role of buying these shares on behalf of its many depositors. Therefore, it is possible to spread ownership over a large number of individuals, lest it should be confined to a small group of rich Malay individuals with higher income and propensity to save.

Internal corporate control which is defined as the legally enforceable power to select, change or dictate the management of the company⁶⁷ is shown by *Tabung Haji*'s share ownership in the respective companies. In this regard, if *Tabung Haji* holds a bigger stake in some of the companies, it has the right to select and influence the management of the company. Some influence could be exerted in terms of providing employment to Muslims and, more importantly, in ensuring that the activities of the company and their subsidiaries are in conformity with the *Shari'ah*.

The distribution of *Tabung Haji* share ownership is quite dispersed in the manufacturing sector, covering various types of industries such as petroleum, foodstuffs, textiles, and electrical and engineering works, while in other sectors such as the agricultural sector, the distribution is rather narrow and limited. This uneven distribution may be attributed to the fact that investments in the agricultural sector involve higher risks and lower returns. Another possible reason could be that the *Tabung Haji* subsidiary companies are already involved in the agricultural sector.

Tabung Haji could play a more effective role in financing economic development

⁶⁷ M. L. Sieh Lee, *The Structure of Ownership and Control of Manufacturing Companies in Malaysia 1974 - 1975*, Unpublished Ph. D Thesis, University of Sheffield, 1975, p. 13.

by extending its investments into other agriculture activities besides primary commodities such as palm oil. Small-scale and agro-based industries in the rural areas are in need of finance. In this regard, *Tabung Haji* could help cover this deficiency through project-financing using contracts of *muḍārabah* and *mushārah* or by financing the purchase of inputs using the contracts of *murābahah* and *bay' bi thaman ājil*.

In the case of short term investment, *Tabung Haji* can still play an indirect role by investing its funds in the Special Investment Account at *BIMB*. Since the conditions for investment in this account are negotiable, a request can be made by *Tabung Haji* that its investment is specifically channelled to finance entrepreneurs in small-scale and agro-based industries.

One of the main problems faced by *Tabung Haji* relates to the profitable disbursement of its surplus liquid funds. In the absence of an Islamic money-market, interest-free short-run financial instruments are not available. The only channel open to *Tabung Haji* is to invest in *BIMB* but returns are relatively low as the bank itself is saddled with excess liquidity.

CONCLUSION

CONCLUSION

At the theoretical level, the concept of Islamic banking on the basis of profit-sharing using *muḍārabah* and *mushāarakah* as modes of operations and financing, was initially developed under the explicit assumption of the strict prohibition of *ribā* in Islam. Practically speaking, however, almost all existing Islamic banks have been established and operated in capitalistic economies where the system of interest persists.

The establishment of an Islamic bank under such an environment is not without justification. Islamic banking is widely recongnized by Muslim scholars as one of the approaches to be adopted in the process of Islamizing an economy. This approach is based on the premise that under the existing political, social and technical constraints, Islamization should be so phased as to avoid any abrupt changes which might cause unpredictable disarray in the economy. According to this approach, Islamization of the banking sector is to be implemented by first establishing a model of an Islamic bank side by side with the existing interest-based banks. It is hoped that, through time, the superiority of the Islamic banking model will cause the practice of interest-based banking to be phased out without any adverse effect on the economy. Experiences so far have shown that Islamic banking and financial institutions can co-exist with conventional banking and financial institutions, and there are signs that they can continue to grow and progress.

A similar approach has been adopted in the implementation of Islamic banking and finance in Malaysia. It was in a capitalistic environment that *BIMB* was established in July 1983. The passing of the *Islamic Bank Act* by the Malaysian

Parliament on March 10, 1983, paved the way for an Islamic bank to operate banking business in the country in line with Islamic principles, rules and practices as contained in Islamic commercial law. Its establishment was motivated by the successful experience of similar financial institutions such as *Tabung Haji (LUTH)*, which was established in 1969 in Malaysia and other Islamic banks in other countries. The main purpose of *Tabung Haji* is to promote and accumulate savings from the Muslims and at the same time co-ordinate all aspects of pilgrimage activities undertaken by its members. The fund is managed according to Islamic principles with the Board of Trustees acting to ensure that the accumulated funds are invested in activities permissible in Islam.

Following the establishment of *BIMB*, a number of measures have been taken to strengthen other Islamic-oriented financial institutions in Malaysia. Such measures include, among others, the setting up in 1985 of the Islamic Insurance Company known as *Syarikat Takaful Malaysia Sendirian Berhad (STMSB)* which operates its *takāful* schemes based on the contracts of *muḍārabah* and *takāful*. These developments became possible after *BIMB* had proved to be a viable institution due partly to the support given by the public in dealing with Islamic banking in Malaysia.

As the Islamic financial sector is in its infancy in Malaysia, it is faced with the major problem of competition with the established conventional sector. However, as the Islamic sector gains maturity and experience the identity problem of the Islamic institutions should be solved and the socio-economic justice behind their establishment be fulfilled. *BIMB*, *Tabung Haji* and *Syarikat Takaful* need to evaluate their mode of operations and goals to have a balance between profit-motivation and service provision. Conventional banking has been in existence for many decades and

is still far from perfect. Therefore, an Islamic alternative must not be expected to work wonders within a short span of time.

Through the example of institutions like *BIMB*, *Tabung Haji* and *Syarikat Takaful*, the Government can show how the Muslims have been helped in mobilising their savings to be used for profitable investment in accordance with the *Shari'ah*. These institutions have been able to raise profit and gain an increasing number of depositors (in the case of *BIMB* and *Tabung Haji*) or participants (in the case of *Syarikat Takaful*) each year, in spite of competition from conventional counterparts. Their profitability, liquidity and viability has led conventional banking and financial institutions to operate interest-free counters which offer an alternative way of investment using various principles of Islamic transactions such as *wadi'ah*, *mud'arabah*, *musharakah*, *murabahah*, *bay' bi thaman ajil*, *ijarah* and *kafalah*.

Likewise *Tabung Haji*, which was established mainly for welfare purposes, has gained a greater role in the development of the Muslim economy in Malaysia and has managed to emerge as one of the largest holding companies there.

Bank Islam Malaysia Berhad (BIMB)

Progress made by the *BIMB* so far is encouraging and the experience is somewhat similar to Islamic banking experiments in other countries. The Bank is expected to continue its progress remarkably in the future, at least in achieving the conventional banking objectives of profitability, liquidity and safety, in view of it being the only Islamic bank granted permission to operate in Malaysia. However, the ultimate criteria for judging the success of the Bank should not be confined to just

the degree to which *ribā* is eliminated from its operation and the size of profits earned in the process. Far more important is the extent to which the Bank helps achieve other desirable goals of the Islamic economic system such as eradication of poverty, optimum utilization of resources, maintenance of economic stability and equitable distribution of income and wealth.

Available evidence clearly suggests that there is a tendency for the Bank to confine its profit-generating operations to almost risk-free techniques to ensure success. Consequently, this has led to the bank's over-reliance on the *murābahah* and *bay' bi thaman ājil* modes of financing rather than the entrepreneur-creating operation of *muḍārabah* and *mushārahah*. To a certain degree, people doubt the Bank's genuine intention to apply Islamic principles in banking. Thus the Bank has been unable to influence the pattern of the distribution of profit between the providers of capital and the users of that capital in a more equitable manner as enjoined in Islam. It may be argued that more meaningful outcomes could have been achieved had the Bank placed greater emphasis on the first-line modes of financing of *muḍārabah* and *mushārahah*.

It is important to note that *muḍārabah* and *mushārahah* investments have been given high importance in the evaluation of the degree of Islamicity of Islamic banks. Confinement to *murābahah* and *bay' bi thaman ājil* transactions will only ensure the Islamic bank the role of freeing itself from interest and nothing else. Such an approach will undermine the bank's potential for the creation of Muslim entrepreneurs as well as the improvement of income distribution in favour of the Muslim business community.

Although in its operation *BIMB* has used all the instruments and mechanisms which are devoid of *ribā*, nevertheless, the main alternatives used are similar to interest. It so happens that the returns on the modes of finance based on *murābahah*, *bay' bi thaman ājil* and *ijārah* are all pre-determined as in the case of interest. Some of these modes are said to contain some risk, but all these risks are insurable. The concentration on these second-line techniques as opposed to partnership (*muḍārabah* and *mushārah*), which, as we have said above, has been regarded by Islamic economists as the most appropriate, has created an identity crisis as to whether *BIMB* is a true Islamic bank. Though various arguments are given by *BIMB* to justify its preoccupation with *murābahah* and *bay' bi thaman ājil* transactions, these are not fully convincing since the mark-up charged by the Bank is often higher than the prevailing interest rate. This might create exploitation of customers which is equally un-Islamic in nature. The ultimate criteria for judging the success of the Bank should not be confined to the degree to which *ribā* is eliminated from its operation. The operation of *BIMB*, which concentrates on second line techniques, could be considered as an example of following the "letter of the law" rather than its "spirit". Even though there is no clear evidence to lead us to disapprove of these techniques, they defeat the spirit of equity and justice as propounded by the *Sharī'ah* principles of profit and loss-sharing.

Syarikat Takaful

Available evidence clearly suggests that *Syarikat Takaful* has been successful in achieving its economic objectives of profitability, viability and safety. However, from the investment point of view, its funds are channelled primarily into short-term

investments such as investment in investment accounts with *BIMB*, the purchase of Malaysian Government Investment Certificates (MGIC) and the purchase of shares and stocks quoted in Malaysia. These types of investments are regarded as almost risk-free investments to ensure success. In this regard, it would be impossible for the *Syarikat Takaful* to exert considerable influence to improve the pattern of profit distribution among the providers and users of capital.

As one of the Islamic financial institutions granted permission to offer and operate Islamic Insurance schemes based on *muḍārabah* and *takāful* contracts, *Syarikat Takaful* could play a more effective role in financing economic development in the country by channelling its funds and monetary sources into various ways of investment, especially in project-financing using contracts of *muḍārabah* and *mushārahah* (financing the entrepreneurs). Then as a second-line activity, it can also finance customers to purchase inputs and fixed assets using the contracts of *murābahah* and *bay' bi thaman ājil*.

Tabung Haji

Tabung Haji is now becoming a big investor in property and stock markets while at the same time one hears of complaints about its management, since its capitalist side appears to be dominant. In addition, the minimum 10 per cent yearly dividend is given irrespective of the outcome of the business, which has parallels with conventional capitalist practices as opposed to those of Islam.

Furthermore, although, *Tabung Haji* has been portrayed as a successful Islamic commercial institution, evidence gathered so far indicates that it has insisted upon

achieving the conventional financial objectives of profitability, liquidity and safety. As such, there is a tendency for *Tabung Haji* to confine its profit-generating operations to almost risk-free techniques to ensure success. In this respect, *Tabung Haji* could play a more effective role in financing economic development in Malaysia by extending its investments into agricultural activities besides primary commodities. Small-scale and agro-based industries in the rural areas are in dire need of finance. *Tabung Haji* could help cover this deficiency through project-financing using *Shari'ah* based contracts such as *muḍārabah* and *mushārah* or by financing the purchase of inputs and fixed assets using the *murābahah* or *bay' bi thaman ājil* or *bay' al-salam* modes of financing.

Despite its shortcomings, *Tabung Haji* has proved its success over more than two decades of operations, and can take pride in the fact that it is the only one of its kind in the world.

Suggestions

Introducing an Islamic financial system in Malaysia is no easy task. Malaysia's multi-ethnic and multi-religious demographic structure makes this task even more challenging. The fact that Islamic financial institutions have been able, so far, to co-exist with other conventional counterparts is, perhaps, to a certain extent indicative of the workability of the Malaysian approach. This, however, does not and should not cloud the fact that legal difficulties have, in fact, shown that while piecemeal tinkering with the conventional economic system may temporarily appease those calling for the gradual Islamization of the entire economic system, such efforts may give rise to serious constitutional and legal issues.

In the case of Islamic banking, we can perhaps suggest a simple solution to the problem of the limited practice of *muḍārabah* and *mushārah* financing by the *BIMB* and other Islamic financial institutions in Malaysia. To this effect, we might leave the existing *BIMB* to continue its present practices and consider it only an 'Islamic commercial bank'. In doing so, we propose the establishment of what could be called an Islamic Merchant Bank which will put more emphasis on *muḍārabah* and *mushārah* financing. We might also retain the term 'Islamic bank' in its general form to be consistent with its distinctive nature and propose the establishment of other Islamic commercial banks which are believed to possess the expertise to provide a wide range of needs to members of the public, especially in the modes of financing. Furthermore, the establishment of another Islamic bank or Islamic counters in existing commercial banks will open the door for healthy competition among Islamic banks and thus improve their efficiency.

One of the important areas where *muḍārabah* and *mushārah* financing would need to be provided is in funding of cottage and small-scale industries. It may be desirable to establish specialised credit institutions with particular financing ability to supplement private sector finance on a profit and loss-sharing basis to support such industries.

Needless to say, *Syarikat Takaful* or *Tabung Haji* would be able to perform better if there were more Islamic investment outlets in the country. This observation calls for the establishment of other Islamic financial institutions such as an Islamic Mortgage Bank, an Islamic Development Bank, Islamic Finance Companies and Islamic Investment Houses which would complement the existing Islamic financial and business institutions.

As regards short-term of investment, *Tabung Haji* and *Syarikat Takaful* can still play an indirect role by investing their funds and monetary resources in the Special Investment Account at the *BIMB*. Since the conditions for investment in this account are negotiable, a request can be made by *Tabung Haji* or *Syarikat Takaful* that its investment is specifically channelled to finance entrepreneurs in any profitable investment including small-scale and agro-based industries using *muḍārabah* or *mushārah* modes of financing.

One of the main problems faced by the Islamic financial institutions in Malaysia such as *Tabung Haji* and *Syarikat Takaful* relates to the profitable disbursement of their surplus liquid funds. In the absence of an Islamic money market and interest-free short-term financial instruments, the only channel open to these financial institutions is to invest in the *BIMB*, but the returns are relatively low as the bank itself is saddled with excess liquidity.

We should also note that the success of Islamic banking in Malaysia requires complementary changes such as the establishment of Islamic non-bank financial institutions, specialised credit institutions, deposit insurance corporations and investment audit corporations. In other words, an Islamic bank cannot exist in isolation in upholding Islamic principles as well as its noble objectives in the business world. It is within this nature of operation that it can effectively help eliminate *ribā* from the economic system and ensure the attainment of a more harmonious and meaningful *ribā*-free equity-based economy.

However, it is also important to note that if the establishment of Islamic banking and finance is considered as part and parcel of the process of Islamization of the

economy, as has been claimed in the case of Malaysia, a mere replacement of *ribā* by a profit-sharing or equity-based system will not suffice. Elimination of *ribā*, after all, is only one aspect of the Islamic economic reforms, as it is not the only virtue that Islam stands for. Thus the achievement of the Islamic economic system must be accompanied by and strengthened through other motivational and structural changes. In other words, the introduction of Islamic banking and finance is only a part of the process and not the be-all and end-all of it.

The establishment of *BIMB* as an example has been a catalyst for the development of other Islamic institutions in the country. One important example is the revitalisation of *Baitul Mal* in various states in Malaysia. The *Baitul Mal* has now broadened its activities into the area of welfare aside from its traditional role as a *zakāt* disbursement body. A few *Baitul Mals* such as the one in Kuala Lumpur have successfully ventured into business and property. The gains from trading are ultimately used to help reduce economic and social inequities amongst the Muslims through the various welfare and social programmes of the *Baitul Mal*.

Finally, it is encouraging to note that Islamic financial institutions in Malaysia are functioning successfully side by side with traditional banking and other financial institutions. This proves the point that it is possible to introduce Islamic principles to the financial system in stages, without having to change overnight the entire nature of the system. Above all, we can also say that by establishing Islamic banks and financial institutions in Malaysia at least we provide more opportunities for devout Muslims to practise their economic activities according to Islamic principles.

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D. INTERVIEWEES

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2. Mohamed Arif b. Abdul Rashid, Head of Dept. of Finance and Administration of *Syarikat Takaful*, Kuala Lumpur, 24/11/94.
3. Che Gayah Salleh, Investment Officer of *Tabung Haji*, Kuala Lumpur, 25/11/94.